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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1935

No. 61

JOHN A. NELSON COMPANY, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITION FOR CERTIORARI FILED MAY 20, 1935.

CERTIORARI GRANTED OCTOBER 14, 1935.

SUPREME COURT OF THE UNITED STATES

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COMMISSIONER OF INTERNAL REVENUE.

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1 John A. Nelson Company, *Petitioner,*
vs.
Commissioner of Internal Revenue, *Respondent.*
} Docket No. 44700.

Appearances:

For Petitioner: B. W. Flinn, Esq., (Withdrawn) Frank E. Seidman, C. P. A.

For Respondent: B. Fullerton, Esq., John D. Kiley, Esq., J. E. Marshall, Esq., C. A. Ray, Esq., Claude Kitchin, Esq.

DOCKET ENTRIES.

Transferred to Mr. Smith 4/8/33.

1929

May 23—Petition received and filed. Taxpayer notified. (Fee paid)

May 24—Copy of petition served on General Counsel.

July 23—Answer filed by General Counsel.

July 24—Copy served on taxpayer—assigned General Calendar.

Dec. 20—Motion to transfer to the Grand Rapids, Michigan, Circuit Calendar, filed by taxpayer. 1/11/3[illegible]anted.

Dec. 26—Notice of withdrawal of B. W. [illegible]n and substitution of Frank E. Seidman as counsel for taxpayer filed. See 41984.

1930

Jan. 11—Notice of appearance of Frank E. Seidman as counsel for taxpayer filed.

May 7—Hearing set June 25, 1930 at Grand Rapids, Michigan.

June 26—Hearing held before W. D. Love, Division 12. Submitted on stipulation of facts. Stipulation of facts filed. Briefs due Nov. 15, 1930.

July 30—Transcript of hearing of June 26, 1930 filed.

Nov. 14—Motion for extension to 2/1/31 to file brief filed by General Counsel. See 32986. 11/18/30 granted.

Nov. 15—Motion for leave to file amendment to petition to conform pleadings to proof filed by taxpayer.

Nov. 15—Brief filed by taxpayer. See 32986.

1931

Jan. 29—Motion for extension of time to Feb. 10, 1931 to file brief filed by General Counsel. Granted.

Feb. 10—Motion for extension to 4/11/31 to file brief filed by General Counsel. 2/10/31 granted.

Mar. 4—Motion of Nov. 15, 1931 granted.

Mar. 11—Answer to amendment to petition filed by General Counsel. Copy served 3/14/31.

Mar. 27—Brief filed by General Counsel.

Apr. 30—Reply brief filed by taxpayer.

Nov. 30—Findings of fact and opinion rendered—Wm. D. Love, Division 12. Judgment will be entered under Rule 50.

Dec. 19—Order that division report promulgated Nov. 30, 1931 be reviewed by the Board entered.

1932

Apr. 13—Order that prior submission be set aside and case reopened for further hearing in Washington, D. C., 5/25/32, at which time parties may offer further evidence entered.

May 7—Motion to offer further, roal and documentary evidence with respect to certain issues filed by General Counsel. 5/13/32 denied.

May 21—Motion for a continuance to July 11, 1932 filed by taxpayer. 5/24/32 granted—hearing continued to July 27, 1932.

June 20—Motion for continuance to 8/10/32 filed by General Counsel. 6/22/32 granted.

Aug. 8—Order striking from calendar of Aug. 10, 1932 and set for Sept. 14, 1932 entered.

Aug. 10—Motion to vacate order of 4/13/32 filed by taxpayer.

Aug. 19—Order that motion filed 8/10/32 be set for hearing Sept. 14, 1932 at Washington, D. C., entered.

Sept. 14—Hearing had before Mr. Love on petitioner's motion to vacate order of April 13, 1932. Petitioner's brief due in 60 days.

Oct. 4—Transcript of hearing 9/14/32 filed.

Nov. 14—Motion for 15 days extension to file brief filed by taxpayer. 11/15/32 granted.

Nov. 28—Brief filed by taxpayer.

1933

May 31—Order that petitioner's motion to vacate order of 4/13/32 be denied entered.

May 31—Memorandum sur order entered.

June 23—Findings of fact and opinion rendered—Charles P. Smith, Division 5. Judgment will be entered under Rule 50.

Aug. 16—Notice of settlement filed by General Counsel.

Aug. 19—Hearing set Sept. 6, 1933 on settlement.

Sept. 6—Hearing had before Mr. Trammell on settlement—not contested—referred to Mr. Smith for decision.

Sept. 6—Consent to settlement filed by taxpayer.

Sept. 7—Decision entered—Charles P. Smith, Division 5.

Nov. 28—Petition for review by U. S. Circuit Court of Appeals, 7th Circuit, with assignments of error filed by taxpayer.

Nov. 28—Proof of service of petition and praecipe filed by taxpayer.

Nov. 28—Praecipe filed.

Dec. 21—Statement of evidence lodged by taxpayer.

Dec. 21—Notice of lodgment of statement of evidence and hearing on Jan. 10, 1934 to approve said statement filed by taxpayer.

1934

Jan. 10—Hearing had before Mr. Goodrich on approval of statement of evidence—respondent accepts petitioner's statement—referred to Mr. Smith for approval.

Jan. 10—Statement of evidence approved and ordered filed.

Jan. 23—Order entered extending the time for transmission and delivery of the record to Jan. 31, 1934.

3 UNITED STATES BOARD OF TAX APPEALS. Filed M 1929.

John A. Nelson Company, Harrison Avenue & Eleventh Sts., Rockford, Illinois
vs.
Commissioner of Internal Revenue, Washington, D. C.
} Docket No. 44700.

PETITION.

Filed May 23, 1929.

The above named petitioned hereby petitions for a re-examination of the deficiency set forth by the Commissioner of

Internal Revenue in his notice of deficiency (Symbols IT: AR: D-60 D WFD) dated March 25, 1929 and as a basis of their proceedings alleges as follows:

1. The petitioner is an Illinois corporation with principal office at Rockford, Illinois and is non-operative at the present time, but was formerly engaged in the manufacture and sale of milling and adding machines.

2. The notice of deficiency, a copy of which is attached and is marked Exhibit "A," was mailed to the petitioner on March 25, 1929.

3. The taxes in controversy are the corporation income taxes for the calendar year 1926.

4. The determination of taxes set forth in said notice of deficiency is based upon the following errors:

(a) The Commissioner of Internal Revenue in computing the tax liability for the calendar year 1926 has erroneously increased income by capitalizing a bonus paid to designers in the amount of $16,686.57.

(b) The Commissioner of Internal Revenue in computing the tax liability for the calendar year 1926 has erroneously increased income in the amount of $322,980.29, which amount represents the reserve for unrealized profit on installment sales.

5. The facts upon which the petitioner relies as a basis for their proceedings are as follows:

(a) During the year 1923 the corporation entered into a contract with Sundstrand Brothers wherein they agreed to pay the Sundstrand Brothers a yearly bonus based on the net profits of the business. This bonus was, according to the contract, payable in consideration of the services to be rendered and services having been rendered in the past and as additional compensation for patents already transfrred to the corporation. Pursuant to the contract, bonuses were paid to the Sundstrand Brothers during the year 1926 and the Commissioner of Internal Revenue has disallowed the bonus paid as compensation and has capitalized the payments made as cost of patents.

(b) For the years prior to 1926 the corporation has reported income of the installment sales on the installment basis. The reserve for unrealized profit on installment sales at December 31, 1926 was $322,980.29. At December 31, 1926 the petitioner transferred all of its assets excepting a certain amount of cash to the Sundstrand Corporation of Delaware in exchange for cash and preferred stock, thus constituting a reorganization.

6. The petitioner prays for relief from the deficiency asserted by the respondent on the following and each of the following particulars:

(a) That in arriving at the tax liability of the John A. Nelson Company for the calendar year 1926 the taxable income as set forth in the Commissioner's letter dated March 25, 1929 should be reduced $16,686.57 representing the bonus paid to the Sundstrand Brothers.

(b) That in arriving at the tax liability of the John A. Nelson Company for the calendar year 1926 the taxable income as set forth in the Commissioner's letter dated March 25, 1929 should be reduced $322,980.29 which amount represents the reserve for unrealized profit on installment sales at December 31, 1926.

Whereof, the petitioner prays that this Board may hear and re-determine the deficiency herein alleged.

(Signed) B. W. FLINN,
Accountant for Taxpayer
501 Manufacturers Nat'l Bank Bldg.
Rockford, Illinois

HUGO L. OLSON, being duly sworn, says that he is the Secretary of the John A. Nelson Company, the taxpayer named in the foregoing petition and as such secretary is duly authorized to verify the foregoing petition; that he has read the said petition or has had the same read to him and is familiar with the facts therein contained and that the facts therein stated are true, except such facts as are stated upon information and belief and these facts he believes to be true.

(Signed) HUGO L. OLSON.

Subscribed and Sworn to before me this 21st day of May, 1929.

(c) ELSIE BROITZMAN,
Notary Public.

6 TREASURY DEPARTMENT

Washington

Office of
Commissioner of Internal Revenue

Address Reply to
Commissioner of Internal Revenue
and Refer to

Mar. 25, 1929

John A. Nelson Company,
Harrison Ave. and 11th Street,
Rockford, Illinois.

Sirs:

In accordance with the provisions of Section 279(a) of the Revenue Act of 1926, there has been assessed against you an income and profits tax amounting to $45,855.03 for the taxable year 1926, the details of which are set forth in the statement attached.

In accordance with the provisions of Section 274(a) of the same act, you are allowed sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter within which to file a petition with the United States Board of Tax Appeals, contesting in whole or in part the correctness of this determination.

However, If You Do Not Desire To Petition, you are requested to execute the enclosed Form 866 and forward both original and duplicate to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7.

Respectfully,

D. H. BLAIR,
Commissioner.

By (Signed) C. B. ALLEN,
Deputy Commissioner.

Enclosures:
Form 866
Form 882
Statement

7 IT:AR:R-60D WFD

Statement of Returns Examined
and
Resulting Tax Liability

Mar. 25, 1929

Returns Examined.

	Year	Form
Parent		
John A. Nelson Company, Rockford, Illinois.	1926	1120 (Cons.)
Subsidiary Companies:		
Sundstrand Adding Machine Company, Rockford, Illinois.	1926	"
Sundstrand Adding Machine Company, New York, N. Y.	1926	"

Tax Liability.

John A. Nelson Company

Year	Correct Tax Liability	Tax Previously Assessed	Deficiency
1926	$99,426.91	$53,571.88	$45,855.03

Sundstrand Adding Machine Company,
Rockford, Ill.
None

Sundstrand Adding Machine Company,
New York, N. Y.
None

The adjustments producing the above deficiency are shown in the attached Schedules 1 to 3, and Exhibit A.

8 Schedule 1.

Net Income.

Net income as disclosed by return	$396,588.76
As corrected	736,255.62
Net adjustment	$399,666.86
Unallowable deductions and additional income:	
(a) Patent bonus	$ 16,686.57
(b) Profit on installment sales	322,980.29
Total	$339,666.86

Schedule 1-A.

Explanation of Items Changed.

(a) Patent bonus paid in 1926 and charged to expense, now capitalized	$ 23,030.83
Amortization allowed	6,344.26
Amount disallowed	$ 16,686.57

For detailed computation see Exhibit A, attached.

(b) Taxpayer has been allowed to report income on the installment sales basis for the years 1918 and 1926, inclusive. The reserve for unrealized profit in installment sales at December 31, 1926, was $322,980.29. See return, Schedule 22-F for computation. As of December 31, 1926, the taxpayer corporation transferred all its assets and liabilities, except certain cash and accounts payable as set forth in return, Schedule M, under a plan of sale merger to the Sundstrand Corporation of Delaware for $2,100,000.00 cash and 14,030 shares of preferred stock realizing 100% for its total outstanding installment accounts receivable. See return, Schedule M for balance sheet date of sale.

9 Schedule 2.

Consolidated Net Income—1926.

Net income as corrected:

John A. Nelson Company, Schedule 1	$736,255.62	
Standard Adding Machine Company of New York, as shown on return	240.01	
Total		$736,495.63

Schedule 3.

Computation of Tax.

Income Tax.

Net income for taxable year, Schedule 2	$736,495.63
Income tax 13½ per cent	99,426.91
Total previously assessed	53,571.88
Additional tax to be assessed	$ 45,855.03

10

EXHIBIT A.

Computation of Amortization of Patent Bonus Capitalization.

Date Acquired	Remaining Life from December 31, 1926	Amount Capitalized Year 1926	Amount Amortized
1911	1½	$853.00	$568.67
1916	6½	853.00	131.23
1916	6½	853.00	131.23
1920	10½	853.00	81.24
1921	11½	853.00	74.17
1922	12½	853.00	68.24
1922	12½	853.00	68.24
1923	13½	853.00	63.18
1923	13½	853.00	63.18
1924	14½	853.00	58.83
1924	14½	853.00	58.83
1924	14½	853.00	58.83
1924	14½	853.00	58.83
1924	14½	853.00	58.83
1924	14½	853.00	58.83
1924	14½	853.00	58.83
1924	14½	853.00	58.83
1924	14½	853.00	58.83
1924	14½	853.00	58.83
1925	15½	853.00	55.03
1925	15½	853.00	55.03
1926	16½	852.98	51.69
1926	16½	852.97	51.69
1926	16½	852.97	51.69
1926	16½	852.97	51.69
1926	16½	852.97	51.69
1926	16½	852.97	51.69
Totals		$23,030.83	$2,257.88

Summary.

	Amount Capitalized	Amortization Allowed	Unamortized Balance
1923 per prior Revenue Agent's report	$11,516.56	$ 1,056.99	$10,459.57
1924 per prior Revenue Agent's report	15,827.68	2,346.62	13,481.06
1925 per prior Revenue Agent's report	19,371.18	4,086.38	15,284.80
12/31/1925 per prior Revenue Agent's report	$46,715.42	$ 7,489.99	$39,225.43
1926	23,030.83	6,344.26	16,686.57
12/31/1925 Totals	$69,746.25	$13,834.25	$55,912.00

ıly 23. 11 * * (Caption—44700) * *

ANSWER.

Filed Jul 23 1929.

The Commissioner of Internal Revenue by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

1. Admits the allegations contained in paragraph 1 of the petition.

2. Admits the allegation contained in paragraph 2 of the petition.

3. Admits the allegations contained in paragraph 3 of the petition.

4. Denies that the Commissioner erred as alleged in subdivisions 4(a) and 4(b) of paragraph 3 of the petition.

5. Denies generally and specifically each and every allegation set forth in taxpayer's petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the taxpayer's apppeal be denied.

(Signed) C. M. Charest,
C. M. Charest,
General Counsel,
Bureau of Internal Revenue.

Of Counsel;
Philip M. Clark,
Special Attorney,
Bureau of Internal Revenue.

PMC MT

12 • • (Caption—44700) • • Filed Mar 1932.

AMENDMENT TO PETITION.

Filed—Mar. 4, 1932.

Now comes the petitioner, by its counsel, Frank E. Seidman, and moves that the petition in this cause be amended in the following respects:

1. That there be added to paragraph 4, sub-division (c) as follows:

(c) The inclusion in income for the year 1926 the amount of $6,864.68 resulting from collections in 1926 on installment sales made prior to 1924.

2. That Paragraph 5 be amended to add sub-division (c), as follows:

(c) The petitioner, in its original 1924 return, filed prior to February 26, 1926, changed its method of reporting income to the installment basis. Its return for 1926 was prepared on the installment basis. In arriving at the deficiency, the Commissioner included in taxable income for 1926 the amount of $6,864.68, representing profit computed by him on collections in 1926 from installment sales made prior to 1924.

3. That Paragraph 6 be amended so as to add sub-division (c) as follows:

(c) That taxable income for the year 1926 should be reduced by $6,864.68.

(s) FRANK E. SEIDMAN,
Counsel for Petitioner,
Grand Rapids Savings Bank Bldg.,
Grand Rapids, Michigan.

13 • • (Caption—44700) • • Filed Mar 1931.

ANSWER TO "AMENDMENT TO PETITION."

Filed Mar. 11, 1931.

Comes now the Commissioner of Internal Revenue by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, and answering the "Amendment to Petition" filed in accordance with the motion granted March 4, 1931, admits and denies as follows:

1. Denies paragraph 4(d) and 5(c) added to the original petition by paragraphs 1 and 2 of the amendment to petition filed in accordance with the motion granted March 4, 1931.

Denies each and every allegation of fact contained in said amendment to petition not hereinbefore specifically admitted, qualified or denied.

Wherefore, it is prayed that the determination of the Commissioner be affirmed.

(Signed) C. M. CHAREST
General Counsel, Bureau of Internal Revenue.

Of Counsel:
BROOKS FULLERTON,
Special Attorney,
Bureau of Internal Revenue.

3/10/31

ent of lence filed 10, 1934.

62 • • (Caption—44700) • •

Lodged Dec. 21, 1933.

Filed Jan. 10, 1934.

The following is the STATEMENT OF EVIDENCE, in narrative form, in the above entitled cause:

The above entitled cause came on for hearing before Honorable William D. Love, member of the United States Board of Tax Appeals, on June 26, 1930, at Grand Rapids, Michigan, J. S. Seidman, Esq. and F. E. Seidman, C. P. A., appearing for John A. Nelson Company, Petitioner, and John D. Kiley, Esq. (C. M. Charest, Esq., General Counsel, Bureau of Internal Revenue) appearing for the Commissioner of Internal Revenue, Respondent.

The petitioner and the respondent entered into a written stipulation which was received by the Board member and the case was submitted on the stipulation of facts. The stipulation as later corrected by motion dated November 14, 1930 of petitioner and consented to by the respondent, reads insofar as is here material, as follows:

"1. The petitioner is an Illinois corporation, with its principal office at Rockford, Illinois. It is now inactive, but during the years 1924 to 1926, inclusive, it was engaged
63 in the manufacture and sale of milling and adding machines under the name of Rockford Milling Machine

Company. In June, 1926, the name of the corporation was changed from Rockford Milling Machine Company to Sunstrand Corporation. In December, 1926, its name was changed to John A. Nelson Company.

"12. On December 31, 1926, petitioner was a party to a reorganization, pursuant to the plan of which it transferred substantially all of its properties to the Sunstrand Corporation of Delaware in exchange for 14,060 shares of the preferred stock of the Delaware Corporation, and $2,000,000 cash. The petitioner immediately used part of the cash so received to retire its own preferred stock and immediately distributed the preferred stock and the balance of the cash so received to its own stockholders, pursuant to the reorganization plan. Exhibits 2 and 3 respectively set forth the contract between petitioner and Elliott-Fisher Company, and the minutes of the meeting of petitioner's stockholders in respect of these transactions.

"13. No gain or loss was recognized or reported by the petitioner in its 1926 return with respect to the transactions set forth in Paragraph 12. This treatment was approved by the respondent, except as set forth in Paragraph 14.

"14. As of December 31, 1926, the books of the petitioner showed a reserve for 'Unrealized Profit' on installment sales in the amount of $322,980.29. The respondent added to petitioner's income, in arriving at the deficiency here in question, the $322,980.29, on the ground that the petitioner col-
64 lected, when it exchanged its assets for stock and cash, 100% for the total outstanding installment accounts receivable.

(Signed) FRANK E. SEIDMAN
Frank E. Seidman,
Attorney for Petitioner.

(Signed) C. M. CHAREST
C. M. Charest,
General Counsel, Attorney for Respondent."

65 "EXHIBIT 2.

"Agreement made this 18th day of November, 1926, between Sundstrand Corporation, a corporation of the State of Illinois (hereinafter called 'Sunstrand Corporation') and Elliott-Fisher Company, a corporation of the State of Delaware (hereinafter called 'the Company'), Witnesseth:

"That in consideration of the sum of One Dollar ($1.00) by each party paid to the other and in further consideration of the mutual agreements of the parties herein contained, it is agreed by and between the parties hereto as follows:

"Sundstrand Corporation represents that it owns the entire Adding Machine Business formerly operated under the corporate name of the Rockford Milling Machine Company, and that it will presently acquire all of the approximately 8½ acres of land and all of the buildings thereon immediately adjacent to its plant, formerly owned by Rockford Tool Company of Rockford (now owned by Sundstrand Machine Tool Company) and that it furthermore owns among other things certain real estate, plant, buildings, cash, accounts and notes receivable, merchandise, tools, equipment, patents, patent rights, licenses, stock in subsidiary companies and other property, tangible and intangible, (all thereof including the said land and buildings to be acquired from Sundstrand Machine Tool Company being sometimes hereinafter referred to as the 'Sundstrand Corporation's property') as will be
66 more fully disclosed by its books and records which are to be subject to examination by the Company as hereinafter provided.

"The Company shall cause a new corporation to be organized having a presently issued capital stock consisting of

"'(a) 12,500 shares of $7.00 preferred stock of the par value of $100. each; each share of such $7.00 preferred stock shall be entitled in preference to the common stock to dividends at the rate of $7.00 per share per annum, payable quarterly upon such dates as shall be from time to time determined by the Board of Directors, and such dividends shall be cumulative from the date of issue of such $7.00 preferred stock. In any distribution of assets other than by dividends from surplus or profits, the $7.00 preferred stock shall also have a preference over the common stock until there shall have been paid on such $7.00 preferred stock $100.00 per share plus all accumulated unpaid dividends thereon and the call premium thereon, if any, applicable with respect thereto in the year of such distribution. The $7.00 preferred stock shall be callable in whole or in part upon any dividend date, upon thirty days previous notice at the option of the corporation at $100.00 per share, plus all accumulated unpaid dividends thereon, if such call is made before the calendar year 1932. After the calendar year 1931 the $7.00 preferred stock shall be callable in whole or in part, upon any dividend date, upon thirty days previous notice at the option of the corpora-

tion on the following basis, plus all accumulated unpaid dividends thereon:

During the calendar year 1932 at $102.00 per share,
During the calendar year 1933 at $104.00 per share,
During the calendar year 1934 at $106.00 per share,
During the calendar year 1935 at $108.00 per share,
During the calendar year 1936 and thereafter at $110.00 per share.

The same basis for the retirement of the preferred stock shall apply in the event of the liquidation of the corporation as is applicable in the case of the optional retirement. The $7.00 preferred stock shall have no voting power unless
67 dividends thereon at the rate herein provided shall be in default in the amount of at least $7.00 per share. In the event of such default, each share of the $7.00 preferred stock shall entitle the holder thereof to one vote until such default shall have been cured. In addition to these provisions, the $7.00 preferred stock shall make provision for the following:

"1. No dividends on the common stock of the corporation shall be declared or paid, unless the corporation has an earned surplus of an amount equalling at least twice the annual dividend requirements on the $7.00 preferred stock, based upon the amount of $7.00 preferred stock outstanding at the date when the common stock dividend is declared.

"2. Except as herein otherwise expressly provided, no change shall be made in the share capitalization of the new corporation which shall increase the number of shares of $7.00 preferred stock outstanding or decrease the amounts which the holders of outstanding $7.00 preferred stock are entitled to receive as dividends or in distribution of assets in preference to shares of the common stock or decrease the price at which the $7.00 preferred stock may be redeemed or otherwise retired unless the holders of two-thirds of the $7.00 preferred stock then outstanding shall consent thereto, in writing or vote therefor at a meeting of stockholders called and held for such purpose.

"3. No mortgage (except purchase money mortgages) creating a lien upon any of the fixed assets of the new corporation nor any issue of prior preference preferred stock shall be made by the new corporation if holders of two-thirds of the $7.00 preferred stock then outstanding shall dissent therefrom by vote by ballot at a meeting called for the purpose. Notice of such meeting, stating the intention of the new corporation to make any such mortgage or any such issue of prior preference preferred stock shall be given to the hold-

ers of the $7.00 preferred stock then outstanding in the manner provided in the by-laws of the new corporation for notice of any special meeting of stockholders.

"(b) 30,000 shares of common stock without nominal
68 or par value; dividends may be paid upon the common stock only when dividends have been paid or funds have been set apart for the payment of dividends as aforesaid on the $7.00 preferred stock for the then current dividend period and after the surplus above mentioned, has been provided; but whenever such surplus shall have been provided and dividends on the $7.00 preferred stock have been paid or funds shall have been set apart for the payment thereof, all as aforesaid, then dividends upon the common stock may be declared payable then or thereafter out of any surplus or net profits then remaining. The $7.00 preferred stock shall not receive any dividends or shares in distribution in excess of the amounts above provided, but the common stock alone shall receive all further dividends and shares in distribution. Each holder of common stock shall be entitled to one vote for each share of such stock held by him.

"It is agreed notwithstanding the foregoing that the new corporation may issue such additional shares of $7.00 preferred stock as may be necessary or desirable in connection with the settlement hereunder of the Profit and Loss of the Sundstrand Corporation between September 30, 1926 and the closing date of the purchase herein contemplated and for the adjustment of the contract between the Sundstrand Corporation and Messrs. Gustaf David and Oscar J. Sundstrand, and for the settlement of a License Agreement under the Gubelman patents and in addition thereto not to exceed 1000 shares for the settlement or adjustment of any other liabilities or contracts of the Sundstrand Corporation assumed by the new corporation. The new corporation may also issue from time to time such additional shares of common stock as may be deemed necessary or desirable for any purpose.

"The new corporation shall be incorporated under the Laws of such state and shall have such powers and charter
69 provisions and such by-laws as counsel for the company may deem necessary or advisable, not inconsistent, however, with the provisions contained herein with respect to the common and preferred stock of the new corporation.

"Sundstrand Corporation will convey and transfer all of the Sundstrand Corporation's property including, without limitation by reason of the enumeration thereof, all of the property and assets of the Sundstrand Adding Machine Com-

pany of Illinois, the Sundstrand Canadian Adding Machine Company, Limited of Toronto, Canada, the Sundstrand Adding Machine Sales Company, Inc., and of all other subsidiary companies, if any, and the land and buildings to be acquired as hereinabove provided from Sundstrand Machine Tool Company to the new corporation or its nominee or nominees, free of any lien, incumbrance, indebtedness or charge thereon or with respect thereto, which could or might affect the title thereto; except, however it shall not convey and transfer the sum of $100,000.00 in cash which is to be retained by the Sundstrand Corporation. It is understood and agreed that the new corporation shall assume all ordinary liabilities of the character and substantially the approximate amount set forth in the attached tentative balance sheet marked Exhibit A and also all outstanding contracts of the Sundstrand Corporation and its subsidiary companies hereinbefore expressly mentioned if the transfer herein contemplated shall be made; but the new corporation shall not, unless it elects so to do, assume or be obligated in any way by or with respect to any liabilities or contracts of the Sundstrand Corporation or its said subsidiaries unless such liabilities or contracts shall have been disclosed to the Company prior to the giving by the Company of the notice required herein to fix the date for the transfer of the property and assets of the Sundstrand Corporation.

"Simultaneously with said transfer, the Company will cause the new corporation to issue to or in accordance with the direction of Sundstrand Corporation, 12,500 shares of the $7.00 preferred stock of the new corporation and to pay to said Sundstrand Corporation, $2,000,000.00 in cash; provided that the Company will also cause the new corporation, as soon as the facts with respect thereto can be ascertained and determined, to issue to or in accordance with the direction of the Sundstrand Corporation, such additional shares of the $7.00 preferred stock of the new corporation as shall equal at $100.00 per share, the amount of net profit, if any, of the Sundstrand Corporation, arising from its business from and after September 30, 1926, to the date of said transfer and provided also that if a loss shall result from the operation of the Sundstrand Corporation's business in the period from and after September 30, 1926 to the date of said transfer, said 12,500 shares of the $7.00 preferred stock of the new corporation shall be reduced on the basis of one share for each $100.00 of such loss. The net profit of the Sundstrand

Corporation for the period from September 30th, 1926 to the date of said transfer as herein provided, shall be calculated in accordance with good accounting practice.

"Simultaneously with, or at the Company's option before, said transfer of the Sundstrand Corporation's property
71 to the new corporation, the Company will cause the new corporation to issue to the Company, 90,000 shares of its common stock upon payment therefor by the Company of the sum of $2,000,000.00 in cash.

"Sundstrand Corporation has submitted to the Company, a financial statement of its assets and liabilities as of September 30, 1926. Said financial statement indicates tangible assets in excess of $2,420,000; Liabilities of approximately $331,000. and Tangible Net Worth in excess of $2,090,000.00. It is represented that the estimated net profit for the year 1926, after all taxes, bonuses and other charges, will be approximately $400,000.00. It is also represented that the assets appearing in the statement of assets and liabilities are valued on the following basis:

"(a) Accounts receivable per balances as shown by the individual detail ledger accounts.

"(b) Inventory at cost or market, whichever is lower.

"(c) Subsidiary companies at book value. (Parent Company Books).

"(d) Fixed Assets per recent appraisal of Coats and Burchard, plus additions at cost, less depreciation.

"(e) Deferred charges—estimated values.

"(f) Patents and good-will, as specifically agreed upon.

"Sundstrand Corporation represents that at the time of such transfer of the Sundstrand Corporation's property to the new corporation, the net worth of Sundstrand Corporation will be such that the financial status of the new cor-
72 poration will then be as good or better than that shown by the tentative balance sheet hereto annexed and marked Exhibit A, less $100,000. in cash, plus any operating profits made by the Sundstrand Corporation, between September 30, 1926 and the date of such transfer.

"The Company shall be afforded a full opportunity to make at its own cost and expense, an exhaustive audit and investigation by such representatives as it may select of the financial status, assets, business and prospects of the Sundstrand Corporation and for that purpose to examine and investigate all of its books, papers, records, products and property and all other matters and details of its business and to con-

tinue such audit and investigation down to the actual time of transfer of the Sundstrand Corporation's property, and if not satisfied from such audit and investigation (a) that the financial status of the new corporation will be as above provided, or (b) in respect to the title to be vested in the new corporation of any of the Sundstrand Corporation's property contemplated to be transferred as aforesaid, or (c) in respect to profits and the value of any of such Sundstrand Corporation's property, or if the Company in its investigation of the business of the Sundstrand Corporation shall find any facts or conditions which in the opinion of the Company may seriously and adversely affect the future prospects and business of the new corporation, the Company shall not be obligated to complete the organization of the new corporation or to otherwise carry out the purchase contemplated by this agreement.

73 "The Company agrees to proceed with due diligence to make the audit and investigation contemplated by the paragraph of this agreement next above.

"The new corporation may at its option use the name Sundstrand Corporation or Sundstrand as or as a part of its corporate name or that of any of its subsidiaries, and the Sundstrand Corporation will when and as requested by the new corporation or the Company make any necessary change in its corporate name or that of any of its subsidiaries or otherwise so that the new corporation and its subsidiaries may be in a position to register to do business in any state in the United States or elsewhere.

"Pending the time of transfer of the Sundstrand Corporation's property to the new corporation, the Sundstrand Corporation shall not, nor shall it permit any subsidiary company, to convey, encumber or otherwise dispose of any of its real estate, improvements or buildings thereon or other fixed assets or any of its patents, patent rights or license agreements, or declare, or pay any dividend or pay any bonus under any contract or contracts or other agreements between Sundstrand Corporation and Gustaf David Sundstrand or Oscar J. Sundstrand or any amount for any Federal Taxes, except approximately $12,000, being the last quarterly payment on 1925 Federal Taxes, or otherwise do any act or thing not in ordinary routine and usual conduct of the business without the written approval of the Company.

74 "The Sundstrand Corporation agrees to assume all liabilities for bonuses to the Sundstrand Brothers arising

from operations in 1926 and all liabilities for income and other taxes in connection with its 1926 profits and all liabilities for all taxes of whatever kind arising and to arise for all years previous thereto and is to be entitled to any refund in Federal or other taxes due or to become due the Sundstrand Corporation whenever receieved.

"If the Company shall be satisfied with the result of the audit and investigation agreed by it to be made as hereinabove provided then it shall so notify the Sundstrand Corporation in writing, and the transfers and payment contemplated to be made by this agreement shall be made on or before December 31, 1926, upon at least ten days previous notice in writing given by the Company to Sundstrand Corporation and such transfers and payment as hereinbefore provided shall be made at the office of the Company in New York City, provided, however, that if by reason of delay by the Sundstrand Corporation in complying with any of the provisions hereof, such audit and investigation is not completed so that such notice can be so given on or before December 20, 1926, the time for giving such notice and for making the transfer and payments hereinbefore provided shall be extended for the number of days equivalent to the length of such delay.

"The Company agrees to cause the new corporation to
75 have its books, accounts and records audited by some reputable firm of certified public accountants annually. The Company further agrees annually and within four months after the close of the Company's fiscal year to cause the new corporation to furnish to a representative of the preferred stockholders selected by them, a copy of a complete report prepared by such auditors. The Sundstrand Corporation shall notify the new corporation in writing prior to February 1, 1927, of the name and address of such representative and the new corporation shall be entitled to recognize such representative until a successor has been appointed in writing by the holders of a majority of such preferred stock then outstanding and the new corporation notified of the appointment of such successor.

"Any notice required hereunder to be given to Sundstrand Corporation shall be sufficiently given if and when deposited in the registered mail with all postage properly paid thereon, addressed to Sundstrand Corporation, Rockford, Illinois.

"This agreement is personal to the parties hereto, and it

shall not be assigned by either without the written consent thereto first obtained of the other, but it shall bind and enure to the benefit of the successors in business of the Sundstrand Corporation and the successors in the business of the Company.

"In Witness Whereof, the parties hereto have duly
76 executed this agreement the day and year first above written.

SUNDSTRAND CORPORATION
By (signed) W. A. BROLIN,
President.

Attest:
(Signed) HUGO L. OLSON
Secretary.

ELLIOTT-FISHER COMPANY
By (Signed) P. D. WAGONER
President.

Attest:
Signed C. S. DUNCAN
Secretary"

77 "EXHIBIT A.

Tentative Balance Sheet
As of Sept. 30—1926

Assets

Cash	$164,834.
Accounts Receivable	525,317.
Inventory	695,711.
Subsidiary Cos.	33,593.
Fixed Assets	984,662.
Deferred Charges	23,446.
Patents & Good Will	1,253,932.
	$3,681,495.

Liabilities	
Current Accounts	$ 69,060.
Accrued Charges	35,532.
Reserve—1925 Federal Taxes	12,787.
Service Contracts	4,116.
Notes Payable	160,000.
Tool Bldg. & Land	50,000.
	$ 331,495.
Capital & Surplus	3,350,000.
	$3,681,495.
Capital and Surplus	
12,500 Shares 7% Pfd.	$1,250,000.
30,000 Shares Common & Surplus	2,100,000.
	$3,350,000.

Book value of Sundstrand Canadian Company Ltd. as reflected by subsidiary Company books is greatly in excess of book value reflected on parent Company books. Parent Company book value used in above figures."

78 "EXHIBIT 3.

"Special Meeting of Stockholders

"Special Meeting of the Stockholders of the Sundstrand Corporation, held at the offices of said Corporation on Eleventh Street, in the City of Rockford, Illinois, at the hour of 7:00 o'clock P. M., on the 18th day of November, A. D. 1926, pursuant to call of the Board of Directors of said Corporation and notice sent by United States mail, postage prepaid, on the 8th day of November, A. D. 1926, to each of the Stockholders of record of said Corporation, which said notice was in the following form, that is to say:

'Notice of Special Meeting
Of Stockholders of Sundstrand Corporation

To _____

You Are Hereby Notified that pursuant to call made by the Board of Directors of this Corporation, a Special Meeting of the Stockholders of the Sundstrand Corporation will be held at the Company's office in the City of Rockford, Illinois, at 7 o'clock P. M., on Thursday the 18th day of November, A. D. 1926, for the purpose of considering and acting upon

a proposition made to this Corporation to sell and dispose of all of its property and assets and for the transaction of any and all business pertaining to the consideration of and action upon said proposal or necessary in connection therewith.

Dated, this 8th day of November, 1926.

HUGO L. OLSON
Secretary'

"W. A. Brolin, President, was present and presided, and Hugo L. Olson, Secretary, was present and acted as Secretary of the meeting.

"Upon roll-call of Stockholders of record of said Corporation, it was found that the owners of 14041 shares of the stock of said Corporation were present, either in person or by proxy.

"The President appointed John A. Nelson and George Lindblade to act as tellers.

"The President ordered the Secretary to submit to the meeting a proposed agreement between this Company and Elliott-Fisher Company which had been approved by the
79 Board of Directors of this Company, providing for a reorganization upon the terms and conditions therein stated and for the sale and transfer of all of the property and assets of this company.

"Upon motion duly made and seconded, said Agreement was ordered marked for identification and filed in the records of the Company.

"Mr. Eric Ekstrom thereupon proposed the adoption of the following Resolutions:

'Resolved that the Stockholders of the Company in meeting duly assembled hereby approve said Agreement, and authorize and direct the sale and transfer of all the property and assets of this Company upon the terms and conditions therein provided; and further

'Resolved that the Board of Directors and Officers of this company be and they hereby are authorized and directed to take such steps and to execute such instrument or instruments including said Agreement, with such modifications thereof or supplements thereto, as in their opinion may be necessary or desirable in order to effect such sale and transfer; and further

'Resolved, that upon the consummation of said reorganization and sale, the proceeds consisting of preferred capital stock and cash received from such sale be distributed im-

mediately to the stockholders in the order of their preferential rights, the preferred stock being first fully redeemed and the balance distributed to the common stockholders; and further

'Resolved, that this corporation, after the consummation of said re-organization and sale under the said agreement with Elliott-Fisher Company and the distribution of the proceeds in accordance with the reorganization plan to its stockholders in the manner provided above, shall cease operation, and the directors and officers thereof shall proceed to liquidate the corporation and cause the same to be dissolved.'

"Mr. Chas. Rystrom seconded the adoption of said Resolutions.

"A vote thereon was then taken by ballot and after a canvass of the vote, the President declared that 14041 shares of the capital stock of this company, being all of the shares represented at this meeting, had been voted for the adoption of said resolutions.

80 "The President then declared that said resolutions had been duly adopted by a unanimous vote of all of the stockholders present in person and represented by proxy and by the holders of more than two-thirds of all of the capital stock of this company issued and outstanding.

"For the purpose of being in a position to comply with one of the requirements in said proposed contract with said Elliott-Fisher Company, Mr. Hugo L. Olson, one of the stockholders of this corporation, presented and moved the adoption of the following resolution:

"Resolved that the name of this Corporation be and is hereby changed from Sundstrand Corporation to John A. Nelson Co.

"The adoption of said Resolution was seconded by Mr. Geo. F. Nelson, one of the stockholders of this corporation, and upon roll-call of the Stockholders, a unanimous vote was cast in the affirmative, for the adoption thereof.

"The President then declared said Resolution duly adopted by the requisite number of votes.

"Mr. Eric S. Ekstrom presented and moved the adoption of the following Resolution:

"Resolved, That we, the stockholders of this Company here assembled, express and convey to Mr. Hugo L. Olson, Secretary and Manager, and to his associates, our most sincere and hearty appreciation of the genuinely loyal and exceedingly efficient services which they have rendered to the

Company and its stockholders throughout the years of its existence and which have resulted in building up a remarkably successful business and establishing an eviable reputation for the Company's product.

"The motion to adopt said Resolution was seconded by Mr. T. E. Swords.

"On vote, the motion was unanimously carried and the Resolution declared adopted.

State of Illinois,
County of Winnebago } ss.

HUGO L. OLSON, being duly sworn, on oath states that he is now, and was on the 8th day of November, A. D. 1926, Secretary of the Sundstrand Corporation; that on the
81 said 8th day of November, 1926, he deposited in and sent by United States Mail, to each of the Stockholders of record of the said Sundstrand Corporation, inclosed in a sealed envelope, postage prepaid, addressed to his or her last known Post-office address, notice of a special meeting of the Stockholders of the said Sundstrand Corporation, to be held at Seven o'clock P. M., on the 18th day of Noyember, A. D. 1926, which said notice was in the following form:

Notice of Special Meeting

Of Stockholders of Sundstrand Corporation

To_____

You Are Hereby Notified that pursuant to call made by the Board of Directors of this Corporation, a Special Meeting of the Stockholders of the Sundstrand Corporation will be held at the Company's office in the City of Rockford, Illinois, at 7 o'clock P. M., on Thursday, the 18th day of November, A. D. 1926, for the purpose of considering and acting upon a proposition made to this Corporation to sell and dispose of all of its property and assets and for the transaction of any and all business pertaining to the consideration of and action upon said proposal or necessary in connection therewith.

Dated, this 8th day of November, 1926.

HUGO L. OLSON,
Secretary

HUGO L. OLSON (Signed)

Subscribed and sworn to before me, this 19th day of November, A. D. 1926.

JOHN A. NELSON (Signed)
(Seal) *Notary Public.*

"Upon Motion duly made, seconded and unanimously carried, the meeting was adjourned.

HUGO L. OLSON (Signed)
Secretary"

82 The foregoing is all of the material evidence adduced at the hearing before the United States Board of Tax Appeals, and the same is approved by the undersigned as attorney for the John A. Nelson Company.

J. S. SEIDMAN
J. S. Seidman

The foregoing is all of the material evidence adduced at the hearing before the United States Board of Tax Appeals, and the same is approved by E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue, attorney for the Commissioner of Internal Revenue.

General Counsel, Bureau of Internal Revenue.

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The foregoing is all of the material evidence adduced at the hearing, and in order that the same may be preserved and made a part of this record, this statement of evidence is duly approved and settled this 10th day of January, 1934.

(S) CHARLES P. SMITH,
Member, United States Board of Tax Appeals.

ov. 30, 14 UNITED STATES BOARD OF TAX APPEALS.

John A. Nelson Company, formerly known as Rockford Milling Machine Company), *Petitioner,* *vs.* Commissioner of Internal Revenue, *Respondent.*	Docket Nos. 32986, 44700.

(Promulgated November 30, 1931.)

1. Distributions as "special compensation" to two inventors who together owned approximately 7½ per cent of petitioner's outstanding common stock, of "five per centum

(5%) of the net profits" of petitioner, held to be capital expenditures.

2. For 1918 to 1923, inclusive, petitioner filed returns on accrual basis. Its return for 1924 was timely filed on installment basis. Respondent approved such change and made refunds for 1918 to 1923, inclusive. Returns for 1925 and 1926, also, were made on installment basis. Held, that collections made in 1924, 1925 and 1926, on account of installment sales made prior to 1924, are not taxable as income in those years.

3. Held, under the circumstances here, that "unrealized profits" on installment sales are not taxable when, in 1926, petitioner as a party to a reorganization, transfers to the second party in such reorganization, substantially all its assets for stock of the second party and $2,000,000 in cash, when such stock and cash are immediately disposed of by petitioner in accordance with the plan of reorganization. *Charles F. Meagher,* 20 B. T. A. 68, followed.

F. E. Seidman, C. P. A., and J. S. Seidman, Esq., for the petitioner.

Brooks Fullerton, Esq., and John D. Kiley, Esq., for the respondent.

These proceedings are for the redetermination of deficiencies asserted by the Commissioner for the years 1924, 1925 and 1926, as follows:

Docket No.	Deficiency Notice dated:	Year	Amount
32986	October 19, 1927	1924	$24,573.08
32986	October 19, 1927	1925	6,145.70
44700	March 25, 1929	1926	45,855.03

In June, 1926, the Rockford Milling Machine Company (Docket No. 32986), changed its name, without change of corporate identity, to Sundstrand Corporation; and in December, 1926, again changed its name, without change of corporate identity, to John A. Nelson Company. The Board holds, therefore, that the John A. Nelson Company is the same corporate identity as the Rockford Milling Machine Company, and ordered that the name "John A. Nelson Company" be substituted in this proceeding for "Rockford Milling Machine Company," and that further proceedings be in accordance therewith.

In its petitions, original and as amended, petitioner asserts that the Commissioner has erred as below:

For 1924:

1. By capitalizing a bonus paid to designers in the amount of $13,481.06.

2. By including as profit $294,452.65 from collections on installment contracts covering sales of prior years.

For 1925:

3. By capitalizing a bonus paid to designers in the amount of $15,284.80.

4. By including $29,009.86 resulting from collections in 1925 on installment sales made prior to 1924.

16 For 1926:

5. By capitalizing a bonus paid to designers in the amount of $16,686.57.

6. By including $6,864.68 resulting from collections in 1926 on installment sales made prior to 1924.

7. By including in income $322,980.29, which amount represents the reserve for unrealized profit on installment sales.

From the Commissioner's determinations as shown by the deficiency notices, timely appeal was taken to the Board, and the cases were consolidated for hearing and decision.

The cases thus consolidated were submitted upon stipulation and briefs. No witnesses were examined, nor was oral argument made. From the stipulation we make the following

FINDINGS OF FACT.

Petitioner is an Illinois corporation, with its principal office at Rockford, Illinois. It is now inactive, but during the years 1924 to 1926, inclusive, it was engaged in the manufacture and sale of milling and adding machines under the name of Rockford Milling Machine Company. In June, 1926, the name of the corporation was changed from Rockford Milling Machine Company to Sundstrand Corporation. In December, 1926, its name was changed to John A. Nelson Company.

17 Petitioner kept its books and prepared its returns on the accrual basis, except for the years prior to 1924, as will appear later.

In December, 1923, petitioner entered into a contract with Gustaf David Sundstrand and Oscar J. Sundstrand, the material parts of which contract, stipulated in substance, are as follows:

The document is captioned "Contract—General Agreement with Inventors" and is a memorandum of agreement between Gustaf David Sundstrand and Oscar J. Sundstrand, parties of the first part, and Rockford Milling Machine Company, a corporation, party of the second part.

It stipulates that the company's entire product consists of machines invented by the parties of the first part, some of which inventions had been patented by letters patent, both domestic and foreign, and as to others, patents had been applied for in all of about twenty inventions, the latest being dated January 9, 1922.

It is stipulated that parties of the first part may invent other devices and improvements on machines then in use, and provides that all such new inventions should be disclosed to and assigned to the party of the second part without further costs. The consideration named in the contract is one dollar, and the mutual promises in said contract set forth.

It stipulates that the party of the second part agrees to pay to the parties of the first part, their legal representatives and assigns, 5 per cent of the net profits of the company from any and all sources, it being understood that if the company should add to its lines machines or articles not invented by the parties of the first part which contribute a substan-
18 tial portion of the company's net profits, such portion shall be excluded in calculating the percentage due to the parties of the first part. Such 5 per cent payments are made payable on an annual basis.

The term of the agreement is stipulated to run from January 1, 1923, to the end of the term of the last to expire of the United States letters patent granted to Rockford Milling Machine Company under this agreement, it being understood that in the event the Rockford Milling Machine Company should assign its business to another, such assignee should assume the liabilities in favor of parties of the first part, and the term should be to the last expiring date of the patents granted to such assignee on inventions of the parties of the first part.

As a part of the contract, there is a draft of a resolution to be passed by the petitioner's board of directors in connection with the contract, which draft was made a part of the contract. The resolution was passed in the same language as the draft at a meeting of petitioner's board of directors held on December 31, 1923.

All the patents and applications for letters patent mentioned in the "Whereas" clauses had been issued to petitioner or acquired by assignment from Gustaf David Sundstrand and Oscar J. Sundstrand on or before the dates of the respective letters patents or applications. Both Sundstrands were in the employ of petitioner throughout all the years in-

volved, and also throughout the taxable years in ques-
19 tion. They worked on the inventions during business hours and conducted their experiments with petitioner's tools and materials. The petitioner had paid and borne all costs of developing, securing, prosecuting, and defending said patents and applications. On December 31, 1923, Gustaf David Sundstrand owned 351 shares and Oscar J. Sundstrand owned 260 shares of a total of 8,250 shares of outstanding common stock of petitioner, each share having a par value of $100 each.

The amounts paid by petitioner under the contract for the years 1924 to 1926, inclusive, were $15,827.68, $19,371.18 and $23,030.83.

Petitioner deducted said amounts in its returns for the years mentioned as compensation for services.

The respondent considered each of these amounts as a capital expenditure, applicable equally to each of the United States patents set forth in the contract. The respondent allowed as a deduction by way of amortization of these amounts (and the amount of $11,516.56 paid by petitioner for the year 1923) $1,289.63 for 1924, $1,739.76 for 1925, and $6,344.26 for 1926, computed on the basis of the remaining life of each of these patents at the end of the years 1924 to 1926, inclusive. The respondent accordingly disallowed as deductions in this respect, $13,481.06 for 1924, $15,284.80 for 1925, and $16,686.57 for 1926.

In its returns for the years prior to 1924, petitioner's net income was not computed on the installment method. In
20 its original return for the year 1924, filed prior to February 26, 1926, it changed its method of reporting net income to an installment basis, and the respondent approved thereof. Respondent then recomputed petitioner's income for the years 1918 to 1923, and refunded to petitioner for the years 1918 to 1923, inclusive, the excess (of tax as returned and paid on the accrual basis) above the tax as shown by said recomputation on the installment basis. Petitioner likewise reported on an installment basis in its original returns for the years 1925 and 1926, and the respondent approved thereof.

In such return for the year 1924, the petitioner excluded, in computing income, amounts received during 1924 on account of installment sales made prior to 1924. The respondent, in determining the present deficiency, added to petitioner's income the amount of $294,452.65 based on amounts re-

ceived during 1924 on account of installment sales made prior to 1924.

In such return for the year 1925, petitioner excluded, in computing income, amounts received during 1925 on account of installment sales made prior to 1924. The respondent, in determining the present deficiency, added to petitioner's income the amount of $29,009.86 based on amounts received during 1925 on account of installment sales made prior to 1924.

21 In the return for the year 1926, petitioner included, in computing income, $6,864.68 as profits received by petitioner during 1926 on account of installment sales made prior to 1924. Respondent made no change in petitioner's 1926 return in respect of profits received by petitioner during 1926 on account of installment sales made prior to 1924.

On December 31, 1926, petitioner was a party to a reorganization, pursuant to the plan of which it transferred substantially all of its properties to the Sundstrand Corporation of Delaware in exchange for 14,060 shares of the preferred stock of the Delaware Corporation, and $2,000,000 cash. Petitioner immediately used part of the cash so received to retire its own preferred stock and immediately distributed the preferred stock and the balance of the cash so received to its own stockholders, pursuant to the reorganization plan. The contract and corporate minutes relative to such reorganization, provide in substance:

Date of agreement November 18, 1926.

The agreement was between Sundstrand Corporation and Elliott-Fisher Company, a Delaware corporation. The stipulated consideration is one dollar and mutual agreements.

Sundstrand Corporation represents that it owns the entire adding machine business formerly operated under the corporate name of Rockford Milling Machine Company, and will presently acquire other designated property. The contract stipulates that the Elliott-Fisher Company shall cause a new corporation to be organized having a presently issued capital stock of:

(a) 12,500 shares of $7 preferred stock, par value $100.

22 (b) 30,000 shares of common stock, no par value.

Additional preferred stock, for specific purposes was authorized.

The Sundstrand Corporation obligated itself to convey to the new corporation all its assets, including patent accounts and notes receivable, to the new corporation, reserving out.

however, $100,000 in cash. The new corporation assumed all the ordinary obligations of the Sundstrand Corporation. The new corporation, in payment for the assets so transferred, issued and delivered to the transferor 14,060 shares of its preferred stock and $2,000,000 in cash.

No gain or loss was recognized or reported by petitioner in its 1926 return with respect to amounts received by petitioner during 1926 on account of installment sales made prior to 1924. Petitioner's treatment was approved by the respondent, except as set forth next below.

As of December 31, 1926, the books of petitioner showed a reserve for "Unrealized Profit" on installment sales in the amount of $322,980.29. The respondent added to petitioner's income, in arriving at the deficiency here in question, the $322,980.29, on the ground that the petitioner collected, when it exchanged its assets for stock and cash, 100 per cent for the total outstanding installment accounts receivable. Included in the $322,980.29 is an amount of $1,640.49 representing uncollected profits on sales made prior to 1924. This amount of $1,640.49 is not included in the amount of $6,864.68 referred to above as profits received by petitioner during 1926 on account of installment sales made prior to 1924.

23 OPINION.

LOVE: The direct issues are three:

1. Whether the amounts paid to the Sundstrands (who were two inventors) for their work in the inception and development of patents, are deductible as expenses, or whether they they should be capitalized as a part of the cost of such patents.

2. Whether collections from sales made prior to 1924 on the so-called accrual basis, may be included in income for 1924, 1925 or 1926, when the collections were made, during which years petitioner was reporting on the installment basis.

3. Whether taxable gain was realized in 1926, when a reorganization occurred from a transfer of installment accounts maturing in subsequent years.

To these direct issues, respondent adds the query whether, for 1924 and 1925, the evidence in the record is sufficient to enable the Board to redetermine petitioner's correct tax liability for those years.

Respondent contends in respect of the years 1924 and 1925, that petitioner has not adduced evidence showing its income

for those years (a) as reported on returns, (b) with changes made by the Commissioner, and (c) as corrected by the Commissioner. Counsel for respondent asserts that the determination of the Commissioner is presumed to be correct, and that the burden of proof is on petitioner to show that the Commissioner is wrong, and that petitioner must show what its correct tax liability is.

24 To clear the way for the consideration of the other issues, we will first dispose of these contentions as applied to this case by denying them. There is no dispute between the parties in regard to the above matters and they are not at issue. The only things that the Board is undertaking to determine in the first instance are the questions at issue. Those once determined by the Board, the "redetermination" of the deficiency and the settlement, follow under Rule 50 of the Board's Rules of Practice, which rule provides, and is intended to provide for, among other things, just such situations as we have here. It would be supererogatory for the Board to consider matters about which the parties are not in dispute. We conceive that we shall have no difficulty, occasioned by lack of evidence, in reaching conclusions in regard to the issues which are before us.

The first of these as we have set them out above, is in regard to the amounts paid to the Sundstrands for their work on the patents.

On December 31, 1923, a written agreement was entered into by and between Gustaf David Sundstrand and Oscar J. Sundstrand, parties of the first part, and petitioner (then known as the Rockford Milling Machine Company), party of the second part, by which provision was made in accordance with a pre-existing "oral understanding," for the assignment to petitioner which had been made by them prior to the date of the written agreement, of "the entire right, title and interest" in eighteen applications for letters patent of the United States, the latest bearing date of January 9, 1922, and eight applications for foreign letters patent, the lat-

25 est, according to the record, being dated January 8, 1921, the assignment "including foreign patent rights" not otherwise specified.

In accordance with the provisions of this agreement and the other facts as we have found them, we hold that these disbursements in 1924, 1925 and 1926, of "five per centum (5%) of the net profits of the company" for each year immediately preceding that in which the distribution was made, were cap-

ital expenditures for property acquired, and as such property, subject to depreciation over the 17-year life of each patent concerned. This rule has been consistently followed by the Board. See *Individual Towel & Cabinet Service Co.*, 5 B. T. A. 158, and cases therein cited. See also *Stephens-Adamson Manufacturing Co.*, 16 B. T. A. 41, confirmed by the Circuit Court of Appeals for the Seventh Circuit, decided July 27, 1931, and reported in 313 C. C. H., p. 8921. On this issue the Commissioner is sustained.

The second question for our determination is the inclusion in taxable income for the years 1924, 1925 and 1926, of collections on installment sales made prior to 1924.

From 1918 to 1926, inclusive, petitioner sold personal property on the installment plan. For 1918 to 1923, inclusive, petitioner reported its income on the accrual basis. In its original return for 1924, petitioner changed its method of reporting income to the installment basis. For 1925 and 1926, also, its returns were prepared on the installment basis. There is no question raised as to the propriety of making the returns on the installment basis, the change from the accrual to
26 the installment basis being authorized by section 212 (d) of the Revenue Act of 1926, as that section was made retroactive by section 1208 of the same Act.

In accordance with the statute, and the regulations thereunder (Article 42 of Regulations 69), petitioner made application for and obtained a refund, for the years 1918 to 1923, inclusive, for the excess tax as returned on the accrual basis and paid for those years, above the tax as shown by recomputation on the installment basis.

In reporting income received for 1924, petitioner, in its return, excluded as being derived from installment sales made prior to January 1, 1924, receipts amounting to $294,452.65. The Commissioner increased petitioner's reported income by that amount.

In reporting income received for 1925, petitioner, in its return, excluded as being derived from installment sales made prior to January 1, 1924, receipts amounting to $29,009.86. The Commissioner increased petitioner's reported income by that amount.

In reporting income for 1926, petitioner, in its return, included receipts derived from installment sales made prior to January 1, 1924, in the amount of $6,864.68. The Commissioner has made no adjustment in connection with that amount.

Petitioner contends that the Commissioner's action in thus increasing its reported income for 1924 and for 1925, and the Commissioner's failure to decrease its reported income for 1926, is in conflict with section 705 of the Revenue Act of 1928, which follows:

27 Sec. 705. Installment Sales—Retroactive.

(a) If any taxpayer by an original return made prior to February 26, 1926, changed the method of reporting his net income for the taxable year 1924 or any prior taxable year to the installment basis, then, if his income for such year is properly to be computed on the installment basis—

(1) No refund or credit of income, war-profits, or excess-profits taxes for the year in respect of which the change is made or any subsequent year shall be made or allowed, unless the taxpayer has overpaid his taxes for such year, computed by including, in computing income, amounts received during such year on account of sales or other dispositions of property made in any prior year; and

(2) No deficiency shall be determined or found in respect of any such taxes unless the taxpayer has underpaid his taxes for such year, computed by excluding, in computing income, amounts received during such year on account of sales or other dispositions of property made in any year prior to the year in respect of which the change was made.

(b) Nothing in this section shall be construed as in any manner modifying section 607, 608, 609 or 610 of this Act, relating to the effect of the running of the statute of limitations.

The provisions of this section apply to all the years in controversy. We are in substantial accord with the opinion of the General Counsel of the Bureau of Internal Revenue as it is expressed in his memorandum 8144, (recorded in C. B. IX-1, p. 173).

28 In the course of his memorandum, the General Counsel analyses the somewhat involved syntax of section 705, and he expresses the opinion, in conclusion, that:

> • • • where a taxpayer properly qualifies under section 705 of the Revenue Act of 1928, in determining deficiencies against the taxpayer there should be excluded in computing income for the year of change to the installment basis and for all subsequent years, amounts received on account of sales or exchanges of property made in years prior to the year of change, and that such procedure should be followed not only for the years involved

> * * * but also for years covered by the Revenue Act of 1928. * * *

Respondent does not apply this opinion of the General Counsel in the instant case. He contends that section 705, quoted *supra*, was enacted solely as a relief measure from double taxation which might result from the operation of the law as construed by the Board in *Blum's, Incorporated*, 7 B. T. A. 737, and that petitioner, having received refunds for 1918 to 1923, inclusive, as provided in section 1208 of the Revenue Act of 1926, is not a taxpayer who "properly qualifies under section 705 of the Revenue Act of 1928." Quoting respondent, he says that:

> Since petitioner, on account of the refund, has not been taxed on the profits which are included in the installment payments on sales of prior years collected in 1924, 1925 and 1926, the action of the Commissioner in including those profits in income for those years does not subject the petitioner to double taxation. Petitioner is not within the purview of the relief provision of section 705 of the 1928 Act and the Commissioner's action in taxing
> 29 the profits as received was correct. * * * The petitioner having two methods of relief available has taken full advantage of one, and has not been subjected to double taxation. Now the petitioner wishes to invoke the other method in his favor and to escape taxation on income which in equity and good conscience should be taxed. Such was not the intent of Congress * * *.

That such is the precise result that will ensue, if we support petitioner's contentions, is obvious, and it may even be admitted that the entire probability supports respondent's contention that such was *not* the intent of Congress, but where the mandate of a statute is clear and free from ambiguity, there are no sufficient grounds for this Board to disregard the statutory provisions merely because in a particular case the application of the statute appears to result in an inequitable or incongruous situation. There is nothing in the statute to indicate that section 705 is purely a "relief measure" available only to those taxpayers who have not received refunds under the other provisions of earlier Acts. We are not here concerned whether "in equity or good conscience" these amounts in question should be taxed. In our judgment the unmistakable mandate of the statute is that they shall not be taxed, and we so hold.

The two preceding issues are raised in all three of the taxable years in question. The third issue applies only to the

last of them, the year 1926. On December 31, of that year, petitioner was a party to a reorganization, and pursuant to the reorganization plan, it transferred substantially all of its properties to the Sundstrand Corporation of Delaware in exchange for 14,060 shares of the preferred stock of the Delaware corporation, and $2,000,000 cash. Petitioner immediately used part of the cash so received to retire its own preferred stock, and still pursuant to the reorganization plan, immediately distributed to its own stockholders the preferred stock of the Delaware corporation, and the remainder of the cash. As of the same date (December 31, 1926) petitioner's books of account showed a reserve for "Unrealized Profit" on installment sales in the amount of $322,980.29. In arriving at the proposed deficiency here in question, respondent added this amount to petitioner's income, on the ground that when petitioner exchanged its assets for stock and cash, it collected 100 per cent of the total outstanding installment accounts receivable. Included in the $322,980.29 is an amount of $1,640.49 representing uncollected profits on sales made prior to 1924, but such $1,640.49 is not included in the amount of $6,864.68 referred to above as profits received by petitioner during 1926 on account of installment sales made prior to 1924.

The question raised is whether the amount of $322,980.29 or any part thereof, is income to petitioner in 1926.

In one form or another, this question has been before the Board upon earlier occasions, and we have considered it as it was presented in the several cases decided. See *Packard Cleveland Motor Co.*, 14 B. T. A. 118; *R. L. Brown*, 14 B. T. A. 609; *Wallace Huntington*, 15 B. T. A. 851; *M. A. Milan*, 16 B. T. A. 1112; *Charles F. Meagher*, 20 B. T. A. 68; *Lucius H. Elmer*, 22 B. T. A. 224; and *Virginia Beach Golf Course Annex Corporation*, 23 B. T. A. 1169.

The pertinent parts of the 1926 Act, which governs here, are:

Sec. 203 (b) (3) No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization • • •

(e) If an exchange would be within the provisions of paragraph (3) of subdivision (b) if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph

to be received without the recognition of gain, but also of other property or money, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchange, * * *

We have closely scrutinized the facts in the case at bar, the Act relating thereto, and the earlier decisions of the Board. The case most closely paralleling the one now before us is *Charles F. Meagher, supra.* The *Meagher* case fell under the provisions of the Revenue Act of 1921, but the Act of 1926, applicable here, though it differs from the earlier Act in the phraseology of some of its provisions, differs in no material respect therefrom in the effect of the sections above quoted, as we read and apply them, nor does respondent contend that it does. The 1926 Act is even more definite and free from ambiguity than the Act of 1921. In the *Meagher* case we said:

We can but conclude that the transfer by petitioner of these installment obligations in a transaction which, under existing law is held not to result in taxable gain, can not be considered as a present realization of income therefrom, and this conclusion is further strengthened
32 by the fact that the determining of a taxable gain from such a transaction is first provided for by the Revenue Act of 1928 in Section 44 (d), * * *

This section is not by its terms made retroactive and, as we pointed out in *Wallace Huntington, supra,* the insertion of this new provision in that act was clearly indicated by the report of the Committee on Finance of the Senate, and the Committee on Ways and Means of the House of Representatives, to be for the purpose of changing the condition existing under the prior revenue acts, including the Revenue Act of 1921 [and the Revenue Act of 1926] here involved, under which it was possible to dispose of installment obligations in a transfer not giving rise to loss or gain and thereby evade tax liability in respect to the income which would otherwise be represented by them.

We are controlled by the *Meagher* case from which we have just quoted, and by *Wallace Huntington, supra.* Accordingly, we hold that no taxable profit was realized by petitioner when in 1926 it transferred to the Sundstrand Corporation of Delaware substantially all of its properties (in-

cluding installment accounts receivable) in exchange for 14,060 shares of the preferred stock of the Delaware corporation, and $2,000,000 in cash.

The amount of $1,640.49 representing uncollected profits on sales made prior to 1924, included in the total amount of $322,980.29, is exempt from taxation under our decision on the second issue herein considered.

JUDGMENT WILL BE ENTERED UNDER RULE 50.

33 • • (Caption—32986 and 44700) • • Entered D 1931.

ORDER.

Pursuant to section 601 (b) of the Revenue Act of 1928 it is directed that the division report in the above entitled proceedings, promulgated November 30, 1931, shall be reviewed by the Board.

(Signed) LOGAN MORRIS,
Chairman.

Dated: Washington, D. C. December 19, 1931.

34 • • (Caption—32986 and 44700) • • • Entered A 1932.

ORDER.

The above styled and numbered proceeding was submitted, under properly executed stipulations, on June 26, 1930, subject to the filing of briefs at a later stipulated date.

Such briefs were duly filed, and the case considered under said stipulations and in view of such briefs.

It was specifically stipulated by the parties, petitioner and respondent, that "On December 31, 1926, petitioner was a party to a reorganization." The question as to whether or not petitioner was a party to a reorganization is vital to one of the major issues in the case.

That question is controlled by section 203 (h) and 203 (i) of the Revenue Act of 1926.

35 In view of the fact that the record discloses facts, particularly the fact that the 30,000 shares of common stock of the transferee corporation, was not held, after such transfer, by the petitioner or its stockholders, which facts unex-

plained in any way, preclude the conclusion that there was a reorganization as contemplated by the statutes cited, the Board is of the opinion that it is not justified in accepting the stipulation of the parties. It is therefore

Ordered that the prior submission of said proceeding be and hereby is set aside and the case reopened for further hearing in Washington, District of Columbia, on May 25, 1932, at 10 o'clock A. M., at which time such pertinent evidence as may be offered by either party on the question of whether or not the petitioner was a party to a reorganization as a result of the deals effected in December 1926, will be received.

(Signed) WILLIAM D. LOVE,
Member United States Board of Tax Appeals.

Dated: Washington, D. C. April 13, 1932.

36 • • (Caption—32986 and 44700) • •

(Stamped) Received Aug 10 1932 U. S. Board of Tax Appeals.

MOTION TO VACATE ORDER.

Filed Aug. 10, 1932.

Comes now the petitioner, by J. S. Seidman, its counsel, and moves this honorable Board to vacate its order dated April 13, 1932, setting aside the prior submission of the case and reopening it for further hearing. In this respect petitioner sets forth the following:

This proceeding was submitted under properly executed stipulations on June 26, 1930, subject to the filing of briefs. Such briefs were duly filed, and the case considered under the stipulations and in view of the briefs. On November 30, 1931 a division report was promulgated which embodied the stipulations in the Findings of Fact and the related Opinion of the division. On December 19, 1931 an order was entered by the Board on its own motion directing that the division report be reviewed by the entire Board. On April 13, 1932, again on its own motion, the Board entered the order here requested to be vacated.

It was specifically stipulated by the parties that "on De-

cember 31, 1926 petitioner was a party to a reorganization".
(The question as to whether or not petitioner was a party
37 to a reorganization is vital to one of the major issues
in the case.) The order of the Board of April 13, 1932, in effect, refuses to accept the stipulation of the parties in respect to the quoted sentence.

Petitioner respectfully submits that this action on the part of the Board is legally untenable and unjustifiable. When the parties to a proceeding stipulate certain ultimate facts, it does not lie in the mouth of the judicial tribunal to say that those are not the facts; nor can the tribunal be heard to say that by reason of other things in the stipulation it doubts whether the ultimate facts therein set forth should have been stipulated and calls for outside evidentiary facts in support of the stipulation.

The parties to a proceeding are presumed to be represented by competent counsel and to be acting in good faith. It is not the function of the tribunal to act as their guardian angel. The office of the tribunal is solely that of deciding the issues on the record made. Where (as here) the parties have painstakingly developed the record by stipulations and have agreed upon an ultimate fact that was never in issue, it is obviously subversive of the sound administration of justice for the tribunal (except on a question such as jurisdiction) to overturn the record, and provoke strife on phases as to which the parties are at peace.

The Board was designed to decide issues, not create them. When, however, it reaches out into new pastures and assumes the role not only of referee but also combatant, it transcends its legal province and takes on a wholly unjustifiable status. It destroys entirely the sanctity of the ju-
38 dicial atmosphere and instead throws confusion into the ranks, with resulting incalculable mischief, by foisting a third party into an exclusively two-party affair.

Such is the havoc wrought in the present case. Both sides have solemnly advised the Board that petitioner was a party to a reorganization and that the Board can decide the case with that fact assumed and assured. Both sides have briefed the case and presented their views based on the sacredness of the facts they have agreed upon. Yet the Board, of its own accord, ordains that a tempest rage where the parties have found a haven in the calm of their stipulated ultimate facts. Clearly such visitation on the part of the Board is le-

gally untenable and unjustifiable. For helpful adjudications in this respect, see:

Hackfield & Co. v. *United States*, 197 U. S. 442, 446-7.
Arkansas Valley Sugar Beet & Irrigated Land Co. v. *Fort Lyon Canal Co.*, 173 Fed. 601, 603.
Seattle, L. S. & E. Ry. Co. v. *Union Trust Co.* 79 Fed. 179, 188, Citing *Lewis* v. *Sumner*, 13 Metc. (Mass.) 269.
United States v. *Davison*, 1 Fed. (2nd) 465, 470.

Wherefore petitioner prays that the Board grant this motion to vacate the order dated April 13, 1932 and that the case stand as originally submitted

J. S. SEIDMAN,
J. S. Seidman.
Counsel for Petitioner,
2 Lafayette Street,
New York City.

Dated, August 9, 1932.

Aug. 19, 39 * * (Caption—32986 and 44700) * *

ORDER.

It is hereby

Ordered that the motion filed August 10, 1932, with the Board by the petitioner in the above-entitled proceeding, requesting that "this honorable Board vacate its order dated April 13, 1932, setting aside the prior submission of the case and reopening it for further hearing," be and the same is hereby set for hearing September 14, 1932, at Washington, D. C.

(Signed) WILLIAM D. LOVE,
(Seal) *Member, United States Board of Tax Appeals.*

Dated Washington, D. C. August 19, 1932.

May 31, 40 * * (Caption—32986 and 44700) * *

ORDER.

On August 10, 1932, the petitioner filed a motion requesting that the Board vacate "its order dated April 13, 1932, setting aside the prior submission of the case and reopening it for further hearing," alleging that the Board's action therein

was "legally untenable and unjustifiable." Careful consideration has been given to the merits of this motion and the effect it has upon the disposition of these proceedings. The premises considered, it is

Ordered that the petitioner's motion be and the same is hereby denied.

(Signed) CHARLES P. SMITH,
Member.

(Seal)

Enter: May 31, 1933.

41 * * (Caption—32986 and 44700) * * Filed M 1933.

MEMORANDUM SUR ORDER.

The above entitled proceedings, duly consolidated, were submitted upon a written stipulation, and a division report, based upon the said stipulation, was promulgated November 30, 1931.

Section 601 (b) of the Revenue Act of 1928 provides that—

"The report of the division shall become the report of the Board within 30 days after such report by the division, unless within such period the chairman has directed that such report shall be reviewed by the Board. * * *

In accordance with the statute, the chairman entered an order on December 19, 1931, directing that the division report "be reviewed by the Board."

On April 13, 1932, the Board, upon its own motion, entered an order setting aside "the prior submission" and reopening the case. In the order, by way of premise therefor, we said:

42 "It was specifically stipulated by the parties, petitioner and respondent, that 'On December 31, 1926, petitioner was a party to a reorganization' The question as to whether or not petitioner was a party to a reorganization is vital to one of the major issues in the case.

That question is controlled by section 203 (h) and 203 (i) of the Revenue Act of 1926.

In view of the fact that the record discloses facts, particularly the fact that the 30,000 shares of common stock of the transferee corporation, was not held, after such transfer, by the petitioner or its stockholders, which facts unexplained in any way, preclude the conclusion that there was a reorganization as contemplated by the statutes cited, the Board is of the opinion that it is not justified in accepting the stipulations of the parties. * * *"

On August 10, 1932, the petitioner filed a motion requesting the Board "to vacate its order dated April 13, 1932, setting aside the prior submission of the case and reopening it for further hearing." On September 14, 1932, a hearing was had upon the petitioner's motion, at which time both parties were given an opportunity to, but neither did, offer further evidence with respect to the question of whether the petitioner was a party to a reorganization; this opportunity was given in accordance with the Board's order which the petitioner seeks to have set aside. Subsequently to the hearing upon the petitioner's motion, counsel for the petitioner filed a brief in which he argued *in extenso* that the stipulation of the parties that the petitioner was a party to a reorganization was binding upon the Board, and that in any event the petitioner was a party to a reorganization. The arguments advanced upon the first point all go to the binding effect of the stipulation of an ultimate fact, whereas, here, we are refusing to accept the stipulation of a legal conclusion, to-wit, whether under the statute this petitioner was a party to a reorganization. In *Jamison Coal & Coke Co.*, 24 B. T A. 554, 556, we said:

"• • • Stipulations can relate only to facts. We can not recognize or give effect to stipulations of law. (Citing authorities)."

The Board's action in entering the order of April 13, 1932, was within its sound discretion and the petitioner's motion is properly denied. See *Garden City Feeder Co.*, 27 B. T. A. 43 ——, promulgated April 10, 1933, for a full consideration of such matters The argument advanced with respect to the question of whether the petitioner was a party to a reorganization will be considered in the report upon the case.

Regardless of the Board's jurisdiction to reopen cases, and notwithstanding petitioner's arguments to the contrary, the statute (section 601 (b) of the Revenue Act of 1928) specifically provides that "The report of a division shall not be a part of the record in any case in which the chairman directs that such report shall be reviewed by the Board." The division report which the chairman ordered reviewed by the Board is therefore no longer a part of the record. The instant report has been prepared upon the basis of the stipulated facts, but by ignoring the legal conclusion as to whether or not the petitioner was a party to a reorganization.

(Signed) CHARLES P. SMITH
Member.

Enter: May 31, 1933.

44 • • (Caption—32986 and 44700) • • Filed Ju 1933.

Promulgated June 23, 1933.

1. Extra compensation based upon a percentage of annual net profits paid to two employees, from whom petitioner had acquired numerous patents and applications for letters patent, held, in the circumstances, to be deductible in the year in which paid.

2. By an original return filed for 1924, the petitioner changed from the accrual to the installment basis of reporting income. The Commissioner adjusted petitioner's returns for several prior years to the installment basis and refunded the difference in the amount of tax paid upon the accrual basis and the amount computed upon the installment basis. In these circumstances, held, the Commissioner properly included in the incomes of 1924, 1925, and 1926, the amount of the collections in those years upon installment sales made prior to 1924.

3. In 1926, in a taxable transaction, the petitioner disposed of its installment sales contracts. Held, the petitioner realized at that time the deferred profit upon such contracts and the amount of the then realized profit was properly included in its taxable income for 1926.

J. S. Seidman, Esq., and F. E. Seidman, C. P. A., for the petitioner.

Brooks Fullerton, Esq., John D. Kiley, Esq., and J. E. Marshall, Esq., for the respondent.

These proceedings, duly consolidated, are for the redetermination of the following income tax deficiencies:

Docket No.	Year	(Seal) Deficiency
32986	1924	$24,573.08
Do	1925	6,145.70
44700	1926	45,855.03

The pleadings, as amended, raise the following issues: (1) Whether the Commissioner erred by capitalizing alleged bonus payments to designers; (2) whether the Commissioner erred in including in taxable income of the respective years the collections in those years on installment sales made prior to 1924; and (3) whether the Commissioner "in computing the tax liability for the calendar year 1926 has erroneously increased income in the amount of $322,980.29, which amount

represents the reserve for unrealized profit on installment sales." The facts were stipulated.

Findings of Fact.

The petitioner is an Illinois corporation, with its principal office at Rockford. During the taxable years 1924, 1925, and 1926 the petitioner, under the name of Rockford Milling Machine Co., was engaged in the manufacture of milling and adding machines. In June 1926, the name of the taxpayer was changed to Sundstrand Corporation, and in December 1926, its name was changed to John A. Nelson Co.

In December 1923, the petitioner entered into a contract with Gustaf David Sundstrand and Oscar J. Sundstrand, which was designated as "General Agreement With Inventors." In so far as material here, the contract is as follows:

Whereas, the Company's entire product consists of machines invented and designed by the parties of the first part; and,

Whereas, the below mentioned United States patents have been granted to the Company on inventions made by the parties of the first part: [Here follows list of nine patents.]

Whereas, the below-mentioned foreign patents have been granted to the Company on inventions made by the parties of the first part: [Here follows list of eight patents.]

and

Whereas, the parties of the first part have filed applications for letters patent of the United States, which applications may be identified in the U. S. Patent Office as follows: [Here follows list of 18 applications for letters patent.]

and

Whereas the parties of the first part have filed applications for foreign letters patent as follows: [Here follows list of eight applications for letters patent.]

and

Whereas the parties of the first part have assigned the entire right, title and interest in said applications, including foreign patent rights, to said Company with the oral understanding that an agreement should be arrived at for the payment of special compensation to the parties of the first part; and

Whereas the parties of the first part have invented other improvements in milling machines, link grinders, adding, listing and calculating machines and cash registers; and

Whereas the parties of the first part may make further in-

ventions and improvements relating to the lines of machinery manufactured by the Company;

and

45 Whereas, said Company desires to acquire all such inventions and improvements relating to the lines of machinery manufactured by the Company which may be made by the parties of the first part during the term of this agreement * * *;

Now, Therefore, in consideration of the promises and of their mutual promises herein set forth and of the payment of One Dollar to the parties of the first part, by said Company, the receipt and sufficiency of which considerations are hereby acknowledged, the parties hereto have agreed together as follows, to wit:

1. The parties of the first part hereby agree to disclose to said Company all inventions relating to milling machines, link grinders, double end lathes, adding, listing and calculating machines and cash registers * * * which they or either of them have heretofore made or may hereafter make during the term of this agreement; to execute at any time upon request, without further or additional consideration, but at the expense of said Company, applications for original, divisional, renewal, reissue or extended letters patent of the United States or of any and all foreign countries on such inventions; to assign the entire right, title and interest in and to all such inventions to said Company; and to render all necessary assistance in making application for and in obtaining such letters patent, and in enforcing any rights or choses in action accruing as a result of such applications or patents, by giving testimony in any proceedings or transactions involving such applications or patents, and by executing preliminary statements and other affidavits.

2. The company agrees to pay to the parties of the first part, their legal representatives or assigns, five per centum (5%) of the net profits of the Company from any and all sources, * * *

* * * * * *

8. The term of this agreement shall be from and including January 1, 1923, to the end of the term of the last to expire of the United States letters patent granted to said Rockford Milling Machine Company under this agreement, it being understood that if the business of said Company shall be divided as provided for in Paragraph 7 hereof, the obligations of said first parties and of the new corporation set forth in

said paragraph shall continue to the end of the term of the last to expire of the letters patent assigned or granted to such corporation in accordance with Paragraph 1 hereof.

9. This agreement shall bind and inure to the benefit of the successors, legal representatives and assigns of the parties hereto.

All of the patents and applications for letters patent referred to in the above agreement had been assigned to the petitioner by the Sundstrands, who were in the employ of the petitioner at all times material to our determination. The Sundstrands worked on the inventions during business hours and conducted their experiments with petitioner's tools and materials. The petitioner had paid and borne all costs of developing, securing, prosecuting, maintaining, and defending the several patents and applications for letters patent.

On December 31, 1923, Gustaf David Sundstrand owned 351 shares and Oscar J. Sundstrand owned 260 shares of a total of 8,250 shares of petitioner's outstanding common stock of the par value of $100 per share.

For the taxable years before us, the petitioner, under the contract, paid the Sundstrands, and in its returns for these years deducted, as compensation for services rendered, the following amounts:

1924	$15,827.68
1925	19,371.18
1926	23,030.83

The respondent disallowed the claimed deductions. The respondent capitalized these payments, to which he added a similar payment for 1923, and has applied the capital expenditure equally to the several United States patents referred to in the contract. Upon the basis of the remaining term of each of these patents at the end of the respective years, the respondent has allowed deductions for the amortization of these expenditures as follows:

1924	$1,289.63
1925	1,739.76
1926	6,344.26

The petitioner kept its books and prepared its income tax returns on the accrual basis, except as hereinafter indicated.

In its original return for the year 1924, filed prior to February 26, 1926, the petitioner changed its method of reporting income to the installment basis, and the respondent approved the change. The petitioner reported its income for 1925 and 1926 upon the installment basis.

The respondent recomputed the petitioner's income tax liability for the years 1918 to 1923, inclusive, and refunded to the petitioner the excess of the tax returned and paid for those years on the accrual basis, above the amount of the tax computed upon the installment basis for those years.

In its returns for 1924 and 1925 the petitioner excluded amounts received in each of those years on account of installment sales made prior to 1924. In determining the deficiencies, the respondent has included such payments in petitioner's income for these years. The amounts excluded by the petitioner and included by the respondent are as follows:

1924	$294,452.65
1925	29,009.86

In its return for 1926 the petitioner included in its income $6,864.68 as profits received in 1926 on account of installment sales made prior to 1924.

On November 18, 1926, the petitioner and Elliott-Fisher Co., a Delaware corporation, entered into an agreement which, in so far as material here, is as follows:

46 The [Elliott-Fisher] Company shall cause a new corporation to be organized having a presently issued capital stock consisting of

(a) 12,500 shares of $7.00 preferred stock of the par value of $100. each; [provision was made for the issuance of additional shares and for the retirement of this preferred stock at stated intervals] * * * The $7.00 preferred stock shall have no voting power unless dividends thereon at the rate herein provided shall be in default in the amount of at least $7.00 per share. * * *

(b) 30,000 shares of common stock without nominal or par value; * * * Each holder of common stock shall be entitled to one vote for each share of such stock held by him.

It is agreed notwithstanding the foregoing that the new corporation may issue such additional shares of $7.00 preferred stock as may be necessary or desirable in connection with the settlement hereunder of the Profit and Loss of the Sundstrand Corporation [petitioner] between September 30, 1926 and the closing date of the purchase herein contemplated * * *. The new corporation may also issue from time to time such additional shares of common stock as may be deemed necessary or desirable for any purpose.

The new corporation shall be incorporated under the Laws of such state and shall have such powers and charter provi-

sions and such by-laws as counsel for the company may deem necessary or advisable, not inconsistent, however, with the provisions contained herein with respect to the common and preferred stock of the new corporation.

Sundstrand Corporation [petitioner] will convey and transfer all of the Sundstrand Corporation's property including, without limitation by reason of the enumeration thereof, all of the property and assets of the Sundstrand Adding Machine Company of Illinois, the Sundstrand Canadian Adding Machine Company, Limited of Toronto, the Sundstrand Adding Machine Sales Company, Inc., and of all other subsidiary companies, if any, and the land and buildings to be acquired as hereinabove provided from Sundstrand Machine Tool Company to the new corporation or its nominee or nominees, free of any lien, incumbrance, indebtedness or charge thereon or with respect thereto, which could or might affect the title thereto; except, however, it shall not convey and transfer the sum of $100,000.00 in cash which is to be retained by the Sundstrand Corporation. * * *

Simultaneously with said transfer, the [Elliott-Fisher] Company will cause the new corporation to issue to or in accordance with the direction of Sundstrand Corporation [petitioner], 12,500 shares of the $7.00 preferred stock of the new corporation and to pay to said Sundstrand Corporation, $2,000,000.00 in cash; provided that the Company will also cause the new corporation, as soon as the facts with respect thereto can be ascertained and determined, to issue to or in accordance with the direction of the Sundstrand Corporation, such additional shares of the $7.000 preferred stock of the new corporation as shall equal at $100.00 per share, the amount of net profit, if any, of the Sundstrand Corporation, arising from its business from and after September 30, 1926, to the date of said transfer and provided also that if a loss shall result from the operation of the Sundstrand Corporation's business in the period from and after September 30, 1926, to the date of said transfer, said 12,500 shares of the $7.00 preferred stock of the new corporation shall be reduced on the basis of one share for each $100.00 of such loss. The net profit of the Sundstrand Corporation for the period from September 30th, 1926 to the date of said transfer as herein provided, shall be calculated in accordance with good accounting practice.

Simultaneously with, or at the Company's option before, said transfer of the Sundstrand Corporation's property to the

new corporation, the Company will cause the new corporation to issue to the Company, 30,000 shares of its common stock upon payment therefor by the Company of the sum of $2,000,000.00 in cash.

Sundstrand Corporation has submitted to the Company, a financial statement of its assets and liabilities as of September 30, 1926. Said financial statement indicates tangible assets in excess of $2,420,000; Liabilities of approximately $331,000 and Tangible Net Worth in excess of $2,090,000.00, It is represented that the estimated net profit for the year 1926, after all taxes, bonuses and other charges, will be approximately $400,000.00. * * *

Sundstrand Corporation represents that at the time of such transfer of the Sundstrand Corporation's property to the new corporation, the net worth of Sundstrand Corporation will be such that the financial status of the new corporation will then be as good or better than that shown by the tentative balance sheet hereto annexed and marked Exhibit A, less $100,000 in cash, plus any operating profits made by the Sundstrand Corporation, between September 30, 1926 and the date of such transfer.

* * * * * *

The new corporation may at its option use the name Sundstrand Corporation or Sundstrand as or as a part of its corporate name or that of any of its subsidiaries, and the Sundstrand Corporation will when and as requested by the new corporation or the Company make any necessary change in its corporate name or that of any of its subsidiaries or otherwise so that the new corporation and its subsidiaries may be in a position to register to do business in any state in the United States or elsewhere.

On November 18, 1926, at a special meeting of the petitioner's stockholders, called—

* * * for the purpose of considering and acting upon a proposition made to this Corporation to sell and dispose of all of its property and assets and for the transaction of any and all business pertaining to the consideration of and action upon said proposal or necessary in connection therewith,

the following resolutions were adopted:

Resolved that the Stockholders of the Company in meeting duly assembled hereby approve said Agreement, and authorize and direct the sale and transfer of all the property and assets of this Company upon the terms and conditions therein provided; and further

Resolved that the Board of Directors and Officers of this

company be and they hereby are authorized and directed to take such steps and to execute such instrument or instruments including said Agreement, with such modifications thereof or supplements thereto, as in their opinion may be necessary or desirable in order to effect such sale and transfer; and further

Resolved that upon the consummation of said reorganization and sale, the proceeds consisting of preferred capital stock and cash received from such sale be distributed immediately to the stockholders in the order of their preferential rights, the preferred stock being first fully redeemed and the balance distributed to the common stockholders; and further

47 Resolved, that this corporation, after the consummation of said re-organization and sale under the said agreement with Elliott-Fisher Company and the distribution of the proceeds in accordance with the reorganization plan to its stockholders in the manner provided above, shall cease operation, and the directors and officers thereof shall proceed to liquidate the corporation and cause the same to be dissolved.

The further unanimous action was taken, as recorded in the following minutes of that meeting:

Resolved that the name of this Corporation be and is hereby changed from Sundstrand Corporation to John A. Nelson Co.

Pursuant to the terms of the agreement with Elliott-Fisher Co., the petitioner's properties were transferred to a new corporation, organized under the laws of the State of Delaware, and the petitioner received therefor 14,060 shares of the preferred stock of the new corporation and $2,000,000 in cash. The petitioner immediately used part of the cash so received to retire its own preferred stock and distributed the 14,060 shares of the new company's preferred stock and the balance of the cash to its common stockholders.

As of December 31, 1926, the books of the petitioner showed a reserve for "Unrealized Profit" on installment sales in the amount of $322,980.29. The respondent added the $322,980.29 to petitioner's income in arriving at the deficiency here in question, on the ground that when it exchanged its assets for stock and cash the petitioner collected 100 per cent for the total outstanding installment accounts receivable. Included in the $322,980.29 is an amount of $1,640.49 representing uncollected profits on sales made prior to 1924. The $1,640.49

is not included in the $6,864.68 representing collections on prior installment sales, reported in 1926.

OPINION.

SMITH: The petitioner contests the respondent's disallowance of the deductions claimed by reason of the payment of 5 per cent of its net profits to the Sundstrands in each of the taxable years before us. The respondent has treated these amounts as capital expenditures, applying them to the several United States patents, and has allowed deductions for their amortization over the remaining term of the patents. The petitioner argues that the patents had been acquired prior to the payments now in question and that:

> * * * Instead * * * of giving the Sundstrands a bonus in some fixed and perhaps arbitrary amount, petitioner and the Sundstrands agreed to have the extra compensation measured by the direct index of the effect of the services of the Sundstrands—petitioner's profits. * * *

The Board has held that the cost of patents, legal expenses incidental to procuring and protecting the patents, and experimental expenses in connection with their development are capital expenditures. See *Beaumont Co.*, 3 B. T. A. 822; *American Seating Co.*, 4 B. T. A. 649; affd. on this point, 50 Fed. (2d) 681; *Buffalo Forge Co.*, 5 B. T. A. 947; *Grand Rapids Show Case Co.*, 12 B. T. A. 1024. See also *Dempster Mill Mfg. Co.* v. *Burnet*, 46 Fed. (2d) 604. However, we also held in *American Seating Co., supra*, that an item of $15,000 representing royalty payments was not to be treated as a capital expenditure.

The agreement with the Sundstrands recited that the petitioner had been granted nine domestic and eight foreign patents on inventions made by the Sundstrands, who had also assigned to the petitioner their entire rights to eighteen domestic and eight foreign applications for letters patent. Apparently, if the amounts in question are to be treated as capital expenditures, the capitalization must be with respect to both foreign and domestic patents and applications therefor.

While the Sundstrands owned shares of stock in the petitioner, no point is made that the payments bore any relation to their stockholdings. Their services were doubtless of value to the petitioner and, in recognition of the Sundstrands' contributions to the success of the enterprise, the petitioner agreed to pay them a percentage of its annual net profits.

Whether we consider the payments based upon a percentage of profits as compensation for services rendered (see *Tyler & Hippach, Inc.*, 6 B. T. A. 636, 641), or as in the nature of a rental or royalty for the use of the product of their inventive genius (see *Webb Press Co., Ltd.*, 3 B. T. A. 247; Office Decision 440, Cumulative Bulletin No. 2, p. 215), such payments were in satisfaction of an obligation relating directly to the business of the particular year for which they were paid. We can not see that these payments add anything to the petitioner's capital investment, it having already acquired the patents and applications therefor. There are further practical difficulties in treating these payments, relating to the business of a particular year and measured by the success of that year's operations, as capital expenditures. These difficulties are the changing base upon which to rest an amortization allowance, the variable terms of the several patents, and the term of the agreement as opposed to the term of the patents, requiring the payments to the Sundstrands even in the last year of the term of a patent or patents, but not requiring payments in a year when there were no profits, even though the cost of the patents would nevertheless be subject to amortization. In these circumstances, we hold that the respondent erred in capitalizing the expenditures involved and that the deductions claimed should be allowed. Cf. *Jamieson Coal & Coke Co.*, 24 B. T. A. 554; *Hutchison Coal Co.*, 24 B. T.
48 A. 973; affd., ... Fed. (2d) ..... (C. C. A., 4th Cir., Apr. 3, 1933); *L. Schepp Co.*, 25 B. T. A. 419, 430; *In re General Film Corp.*, 274 Fed. 903.

The second issue is whether the amounts collected in the respective taxable years upon installment sales made prior to 1924 are to be included in the income of the year of collection. The petitioner relies upon the provisions of section 705 (a) (2) of the Revenue Act of 1928, which is as follows:

> (a) If any taxpayer by an original return made prior to February 26, 1926, changed the method of reporting his net income for the taxable year 1924 or any prior taxable year to the installment basis, then, if his income for such year is properly to be computed on the installment basis—
>
> * * * * * *
>
> (2) No deficiency shall be determined or found in respect of any such taxes unless the taxpayer has underpaid his taxes for such year, computed by excluding, in computing income, amounts received during such year on account of sales or other dispositions of property made

in any year prior to the year in respect of which the change was made.

The facts are not in dispute, and, viewing the matter purely from the standpoint of the original installment sales returns for 1924 and subsequent years, the petitioner is within the letter of the statute. But, "A thing may be within the letter of a statute and not within its meaning, and within its meaning, though not within its letter. The intention of the lawmaker is the law." *Smythe* v. *Fiske,* 23 Wall. 374, 380. We have held that where a taxpayer, by an original return filed within the time prescribed by statute, changes from the accrual to the installment basis of reporting its income, "no deficiency shall be determined on account of amounts received during the taxable year from sales made in years prior to that of the change to the installment basis." *Tull & Gibbs, Inc.,* 21 B. T. A. 1073, 1074. See also *S. Davidson & Bros., Inc.,* 21 B. T. A. 638; *Grand Rapids Show Case Co., supra.*

In *Jacob Bros. Co.* v. *Commsisioner,* 50 Fed. (2d) 394, 396, the Circuit Court of Appeals for the Second Circuit determined that uncollected profits upon installment sales which had been reported upon the accrual basis should be included in invested capital of the years following a change to the installment basis of reporting income. The court said, *inter alia:*

> * * * Section 705 permits the taxpayer to exclude from the later year's income cash collected on installment contracts reported on the accrual basis in years prior to the change of method. In other words, *the accrual method was allowed to stand unaffected in respect to income for years prior to* 1918. Hence the surplus and undistributed profits account obtained by the accrual method is likewise unaffected by the change. * * * (Italics supplied.)

Under section 212 (d) of the Revenue Act of 1926, the Commissioner was given authority to prescribe regulations for reporting income upon the installment basis. Article 42, Regulations 69, provides such regulations for reporting income from the sale of personal property on the installment plan, and further that:

> The provisions of this article shall be retroactively applied in computing income from the sale of personal property under the Revenue Acts of 1916, 1917, 1918, 1921, and 1924, or any such Acts as amended. (See sec-

tion 1208). Any dealer in personal property on the installment plan whose books of account contain adequate information and were kept so that income can be accurately computed on the installment basis in accordance with the provisions of this article may file amended returns accordingly, and the excess of the amount of any tax previously paid over the tax as computed on the installment basis as herein provided shall, subject to the statutory period of limitations properly applicable thereto, be credited or refunded as provided in section 284 and articles 1301-1306.

The facts show that the respondent recomputed the petitioner's tax liability for the years 1918 to 1923, inclusive, and refunded to the petitioner the excess of the tax paid for those years on the accrual basis above the amount of the tax computed upon the installment basis. The petitioner, having received the benefit of such readjustments to its income, insists that it should receive afurther benefit by excluding the amount of the collections in 1924, 1925, and 1926 upon installment sales prior to 1924 from its income for those years. We do not believe such dual benefits were intended by Congress. The accrual method used by this taxpayer was not allowed to stand and is affected by the adjustments made by the respondent, and the refunds accepted by the petitioner in accordance with article 42 of Regulations 69. "Men must turn square corners when they deal with the Government." *Rock Island, A. & L. R. Co.* v. *United States,* 254 U. S. 141. This petitioner, having received the benefit of the change to the installment basis of reporting income, not only for the years following the change but also for the years prior to that change, should not be heard to complain because the respondent has included in its income for 1924, 1925, and 1926, amounts representing collections upon installment sales of prior years, which otherwise would go untaxed. Otherwise, this petitioner's true income would not be properly returned for taxation. In these circumstances, the respondent is sustained.

The remaining issue is whether the respondent has erroneously included in income for 1926 an amount of $322,980.29, representing "the reserve for unrealized profit on installment sales." It appears that the petitioner disposed of the installment sales contracts to which this amount relates in 1926, and the respondent has treated the disposition as a realization of the profit. The petitioner contends that the disposi-

tion was a part of the transaction resulting in a reor-
49 ganization to which it was a party, and therefore no gain is to be recognized thereon.

These proceedings were submitted upon a stipulation, in which appears the following statement: "On December 31, 1926, petitioner was a party to a reorganization." In *Jamison Coal & Coke Co., supra,* we said:

> • • • Stipulations can relate only to facts. We can not recognize or give effect to stipulations of law. • • •

On brief—

> The respondent contend(s) that the $322,980.29 represented profits which the petitioner made *at the time the merchandise was sold.* By virtue of Sections 212 (d) and 1208 of the Revenue Act of 1928, petitioner, because it had sold on the installment plan, was given a special privilege. That privilege was the right to defer payment of taxes on the profits on installment sales until the collection of the installment payments. • • •
>
> When the petitioner disposed of those accounts receivable it, by its own voluntary act, terminated its right to the privilege of deferment, and since it received dollar for dollar in stock and cash for those accounts receivable, the portion of such accounts representing income became realized profit to the petitioner—not a profit resulting from or coming into existence on account of the reorganization (*sic*), but merely the collection of a profit earned prior to that time. • • •

In *Packard Cleveland Motor Co.,* 14 B. T. A. 118, the Board held that the taxpayer realized income upon the sale of installment obligations in the taxable year. The provisions of section 44 (d) of the Revenue Act of 1928 lend color to the respondent's contention, but that section of the statute is not retroactive in its effect. In *Wallace Huntington,* 15 B. T. A. 851, we held that the taxpayer realized no income from the gift of installment obligations. In *Virginia Beach Golf Course Annex Corp.,* 23 B. T. A. 1170, we held that the taxpayer realized no income from the distribution of installment obligations to its stockholders.

Charles F. Meagher, 20 B. T. A. 68, involved a disposition of installment obligations in an exchange of property for stock. The syllabus of that case follows:

> Gain or Loss—Exchange—Installment Obligations.—Petitioner, doing business as a sole proprietor, to a large

extent on the installment basis, organized a corporation to which he transferred in 1923 all of the assets of the business for all of its authorized capital stock. Included in the assets conveyed were $117,863.13 of uncollected installment obligations representing unrealized profits of $53,488.57. *Held* that the transfer of these installment obligations, being a transaction provided by section 202 (c) (3) of the Revenue Act of 1921 not giving rise to gain or loss, respondent erred in including in petitioner's income for the year 1923 the sum of $53,488.57 as a profit realized by reason of petitioner's disposition of them in this manner.

The facts of the *Meagher* case clearly established a nontaxable exchange within the purview of section 202 (c) (3) of the Revenue Act of 1921. In disposing of the respondent's contention that "the amount represented by the profit included in the installment obligations would escape tax", we said:

> * * * that result does not necessarily follow, as this petitioner has received in the transaction stock of the corporation in exchange for the assets conveyed, and the realization as income of the value represented by the profit included in the amount of the installment obligations in question, is merely deferred until the sale by him of the stock received upon such sale, as his gain would be measured upon the basis of the cost to him of the transferred assets, which would not include the $53,488.57 of profit included in the $117,863.13 of installment obligations.

In the instant proceedings this corporate taxpayer transferred all of its assets, including the installment obligations, except $100,000 in cash, to the new corporation in exchange for $2,000,000 in cash and 14,060 shares of the new company's preferred stock of the par value of $100 per share. The Elliott-Fisher Co. paid into the new corporation the $2,000,000 of cash and received all of the new corporation's voting stock. The petitioner used a portion of the cash to retire its own preferred stock and distributed the balance of the cash and the 14,060 shares of preferred stock to its common stockholders. It does not appear that the petitioner corporation has ever been dissolved.

The petitioner contends that there was a reorganization to which it was a party and that no gain or loss is to be recognized upon the transfer of its property to the new corporation. Unlike the transfer in the *Meagher* case, this petitioner

neither transferred all of its property nor received all of the stock of the transferee. The pertinent portions of the Revenue Act of 1926 are set out in the margin.[1]

50 The petitioner was not a party to a reorganization within the meaning of the statute. Upon the transfer, pursuant to the terms of the confract of sale, the petitioner neither transferred all of its property nor received "a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock" of the new corporation. Nor does it appear that this petitioner was ever in control of the new corporation, or that the new corporation was in control of the petitioner. Furthermore, while the transferee may be said to have acquired substantially all the properties of this petitioner, disregard-

[1] SEC. 203. (a) Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 202, shall be recognized, except as hereinafter provided in this section.

* * * * * * *

(b) (3) No gain or loss shall be recognized if a corporation a party to a reorganization exchanges property, in pursuance of the plan of reorganization, solely for stock or securities in another corporation a party to the reorganization.

* * * * * * *

(c) If an exchange would be within the provisions of paragraph (3) of subdivision (b) if it were not for the fact that the property received in exchange consists not only of stock or securities permitted by such paragraph to be received without the recognition of gain, but also of other property or mney, then—

(1) If the corporation receiving such other property or money distributes it in pursuance of the plan of reorganization, no gain to the corporation shall be recognized from the exchahge, but

(2) If the corporation receiving such other prop[illegible] money does not distribute it in pursuance of the plan of reorganizatio[illegible] gain, if any, to

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the corporation shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property so received, which is not so distributed.

* * * * * * *

(h) As used in this section and sections 201 and 204—

(1) The term "reorganization" means (A) a merger or consolidation (including the acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation, or substantially all the properties of another corporation), or (B) a transfer by a corporation of all or a part of its assets to another corporation if immediately after the transfer the transferor or its stockholders or both are in control of the corporation to which the assets are transferred, or (C) a recapitalization or (D) a mere change in identity, form, or place of organization, however effected.

(2) The term "a party to a reorganization" includes a corporation resulting from a reorganization and includes both corporations in the case of an acquisition by one corporation of at least a majority of the voting stock and at least a majority of the total number of shares of all other classes of stock of another corporation.

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ing, for the moment, the petitioner's retention of $100,000 in cash, and thereby became the "corporation resulting from a reorganization", and as such is "a party to a reorganization", that does not make this petitioner "a party to a reorganization" since that term includes both corporations (transferee and transferor) only in the event that one acquires at least a majority of the voting and other stock of the other. Here, the petitioner acquired only nonvoting stock in the new corporation, and that corporation acquired none of the petitioner's stock. The petitioner has not brought the transactions within the provisions of section 203 (h). As the Supreme Court said in *Pinellas Ice & Cold Storage Co.* v. *Commissioner*, 287 U. S. 462, "Certainly, we think that to be within the exemption the seller must acquire an interest in the affairs of the purchasing company more definite than that incident to ownership of its short term purchase money notes." Little more than that was acquired by this petitioner, since definite provision was made in the agreement with Elliott-Fisher Co. for the retirement of the nonvoting preferred stock issued to the petitioner. See also *Cortland Specialty Co.* v. *Commissioner*, 60 Fed. (2d) 937.

The exemption provided in section 203 (b) (3) relates to exchanges of property by "a corporation a party to a reorganization", and is enlarged by section 203 (e) on condition that the transferee distribute the money and property received upon the exchange "in pursuance of the plan of reorganization." There is nothing in the agreement with Elliott-Fisher Co. directing the distributions that the petitioner made to its stockholders. That agreement apparently contemplated the continuance of the petitioner's corporate existence, for provision was made, and later acted upon, whereby the corporate identity of the petitioner was changed from Sundstrand Corporation to John A. Nelson Co. Furthermore, the petitioner's stockholders authorized "the sale and transfer" of its property and assets, and the distribution of the consideration "received from such sale." In these circumstances, the transaction involved can not be said to have been a nontaxable exchange of property. Cf. *Howard F. Burns, Executor*, 28 B. T. A. No. 6 (May 5, 1933); *Connecticut Power Co.*, 28 B. T. A. No. 7 (May 5, 1933).

The fact that the petitioner disposed of its installment obligations in a taxable transaction distinguishes this case from the *Meagher* case, *supra*, and we accordingly hold that the respondent properly determined that the petitioner realized

the deferred profit upon installment obligations when it disposed of the obligations in 1926, there being nothing in the record to indicate that the petitioner did not receive the full face value of such obligations.

Reviewed by the Board.

JUDGMENT WILL BE ENTERED UNDER RULE 50.

TRAMMELL, MURDOCK, GOODRICH, LEECH and ADAMS concur in the result.

VAN FOSSAN dissents.

51 • • (Caption 32986 and 44700) • • Entered Sep. 7 1933.

DECISION.

Pursuant to the findings of fact and opinion of the Board in the above-entitled proceedings promulgated June 23, 1933, the respondent on August 16, 1933, filed a notice of settlement. Hearing was had thereon on September 6, 1933, at which time counsel for the petitioner filed an acquiescence to the computation filed by the respondent. Wherefore, it is

Ordered and Decided that the liability of the petitioner to income tax is as follows:

Year	Income Tax Liability	Income Tax Assessed	Deficiency in Payment	Overassessment to be Abated
1924	$33,612.54	$33,612.54	None	None
1925	54,634.75	54,634.75	None	None
1926	97,174.22	99,426.91	$43,602.34	$2,252.69

(Signed) CHARLES P. SMITH,
Member.

Entered Sep. 7, 1933.

Enter:

CPS:aa.

52 • • (Caption) • • Filed Nov. 28 1933.

PETITION FOR THE REVIEW OF DECISION OF THE UNITED STATES BOARD OF TAX APPEALS.

Filed Nov. 28, 1933.

To the Honorable Judge of the United States Circuit Court of Appeals for the Seventh Circuits:

John A. Nelson Company, in support of this petition, filed

in pursuance of Section 1001 of the Act of Congress approved February 26, 1926, entitled The Revenue Act of 1926, for the review of the decision of the United States Board of Tax Appeals rendered on September 7, 1933, determining a deficiency in payment of income tax of this Petitioner for the calendar year 1926 of $43,602.34, respectfully shows to this Honorable Court as follows:

I.

Statement of the Nature of the Controversy.

1. On May 23, 1929, the Petitioner filed with the United States Board of Tax Appeals (hereafter referred to as
53 the Board) in accordance with the provisions of the Revenue Act of 1926, its petition for the redetermination of the deficiency in income tax for the calendar year 1926, in the sum of $45,855.02 as proposed by the respondent and set forth in the final notice of deficiency mailed to the petitioner by the respondent on March 25, 1929. Said petition, insofar as is here material, alleged in part as follows, namely that:

The petitioner is an Illinois corporation with principal office at Rockford, Illinois and was formerly engaged in the manufacture and sale of milling and adding machines. The taxes in controversy are income taxes for the calendar year 1926.

Prior to 1926, the petitioner reported income from instalment sales on the instalment basis. The reserve for unrealized profit on said instalment sales on December 31, 1926 was $322,980.29. At December 31, 1926, petitioner in a reorganization transferred substantially all of its assets to the Sunstrand Corporation of Delaware, in exchange for cash and preferred stock of that company. The respondent erroneously added said reserve of $322,980.29 to petitioner's income for the year 1926 and computed the deficiency accordingly.

2. Thereafter, on July 24, 1929, the respondent filed with the Board, his answer to said petition which answer admitted that petitioner is an Illinois corporation, formely engaged in the manufacture and sale of milling and adding machines. It admitted that the deficiency notice was mailed to the petitioner on March 25, 1929 and that the taxes in controversy
54 are for the calendar year 1926; but denied the remaining allegations of fact in the petition.

Thereafter, the petitioner filed amendments, not here ma-

terial, to the petition on November 15, 1930. Permission therefor was granted by the Board on March 4, 1931, and answer thereto filed by the respondent on March 11, 1931.

3. The cause being at issue under the Rules of Practice of the Board, it duly came on for hearing on June 26, 1930, whereupon the petitioner and respondent submitted a stipulation of facts and agreed that the Board determine the appeal from said stipulated facts. The pertinent facts contained in the stipulation, as later corrected by motion dated November 14, 1930, of petitioner and consented to by the respondent, are as follows:

The petitioner is an Illinois corporation, witth its principal office at Rockford, Illinois. It is now inactive, but during the years 1924 to 1926, inclusive, it was engaged in the manufacture and sale of milling and adding machines under the name of Rockford Milling Machine Company. In June 1926, the name of the corporation was changed from Rockford Milling Machine Company to Sunstrand Corporation. In December 1926, its name was changed to John A. Nelson Company.

On December 31, 1926, petitioner was a party to a reorganization, pursuant to the plan of which it transferred substantially all of its properties to the Sunstrand Corporation of Delaware in exchange for 14,060 shares of the pre-
55 ferred stock of the Delaware Corporation, and $2,000,000 cash. The petitioner immediately used part of the cash so received to retire its own preferred stock and immediately distributed the preferred stock and the balance of the cash so received to its own stockholders, pursuant to the reorganization plan. The contract between petitioner and Elliott-Fisher Company, and the minutes of the meeting of petitioner's stockholders in respect of these transactions were attached to the stipulation.

No gain or loss was recognized or reported by the petitioner in its 1926 return with respect to the said transfer of its properties to the Sunstrand Corporation of Delaware. This treatment was approved by the respondent except as to the reserve for unrealized profit on instalment sales which amounted to $322,980.29 as of December 31, 1926. The respondent added to petitioner's income, in arriving at the deficiency here in question, the $322,980.29, on the ground that the petitioner collected, when it exchanged its assets for stock and cash, 100% for the total outstanding instalment accounts receivable.

4. Thereafter, on November 30, 1931, the Board promulgated its findings of fact in accordance with said stipulation. Along with its findings of fact, the Board rendered an opinion, 24 B. T. A. 1031, in which it "Held, under the circumstances here, that 'unrealized profits' on installment sales are not taxable where in 1926 petitioner, as a party to a reorganization, transferred substantially all its assets for stock of the second party in the reorganization and $2,000,000 in cash, and such stock and cash were immediately dis-
56 posed of by petitioner in accordance with the plan of reorganization".

On December 19, 1931, the Chairman of the Board directed, pursuant to section 601 (b) of The Revenue Act of 1928, that said division report in the above entitled proceeding, be reviewed by the Board.

On April 13, 1932, the Board issued an order in which it, of its own motion, set aside the prior submission of the case, and called for proof of the stipulated fact that "On December 31, 1926, petitioner was a party to a reorganization".

On August 10, 1932, petitioner filed a motion to vacate the Board's order of April 13, 1932.

The proceedings came on for hearing on September 14, 1932, at which time, said motion was also heard. Petitioner challenged the right of the Board to conduct further hearings under the circumstances, and offered no further evidence; neither did respondent.

On May 31, 1933, the Board issued a memorandum sur order and an order denying petitioner's motion of August 10, 1932, to vacate its order of April 13, 1932.

On June 23, 1933, the Board promulgated its findings of fact and rendered its opinion, 28 B. T. A. No. 94, five members separately concurring and one dissenting in the result. Said findings and opinion, contrary to and inconsistent with the stipulation of facts filed with the Board on June 26, 1930, held that petitioner was not a party to a reorganization in
57 connection with the transfer of its assets to Sunstrand Corporation of Delaware; it further held, contrary to and inconsistent with the stipulation and to the respondent's own action in the matter, that the transaction involved was a taxable exchange of property. The Board thereupon held that petitioner realized a taxable profit of said $322,980.29; and the Board entered decision accordingly, in favor of the respondent.

5. On September 7, 1933, the Board entered its final order of redetermination fixing a deficiency of $43,602.34 for the year 1926.

II.

Designation of Court of Review.

The petitioner, being aggrieved by the said opinion, decision and order of the Board, and being a corporation with its principal place of business in the City of Rockford, State of Illinois, desires a review thereof in accordance with Section 1002 (b) of The Revenue Act of 1926 by the United States Circuit Court of Appeals for the Seventh Circuit, within which circuit is located the office of the Collector of Internal Revenue, Chicago, Illinois, to whom the said petitioner made its income tax return for the year in controversy.

III.

Assignments of Error.

Assignments of Error.

The Petitioner, as a basis of review, makes the following assignments of error:

58

1. The Board had no legal power to reopen the submission of the proceedings and bring the case up for rehearing.

2. The Board had no legal power to overturn the stipulated facts and make a finding opposed to the stipulated facts.

3. The Board erred as a matter of law in ignoring and subverting the stipulation of the parties; and in failing to find as facts, the facts stipulated by the parties on June 26, 1930; and in finding facts and rendering a decision inconsistent with and contrary to said stipulation and the evidence in the proceeding.

4. The Board erred in failing to find as a fact that on December 31, 1926, petitioner was a party to a reorganization pursuant to the plan of which it transferred substantially all of its properties to the Sunstrand Corporation of Delaware in exchange for 14,060 shares of the preferred stock of the Delaware corporation and $2,000,000 cash; and in failing to find that in further pursuance of the reorganization plan, the petitioner immediately distributed part of the cash so received to retire its own preferred stock and immediately

distributed the remainder of the cash and the preferred stock to its own stockholders.

5. The Board erred as a matter of law in holding that petitioner was not a party to a reorganization; in holding that the transaction here involved, was a taxable exchange of property; and in holding that the petitioner realized a profit from the transfer of its instalment accounts receivable in said transaction.

59 6. The Board erred in failing to hold that the petitioner was a party to a reorganization; in failing to hold that the transaction here involved was a non-taxable exchange of property in a reorganization; and in failing to hold that petitioner realized no taxable profit from the exchange of its instalment accounts receivable in such non-taxable reorganization.

7. The Board erred in setting aside the findings of fact and decision which its division promulgated on November 30, 1931.

8. The Board erred in ordering on April 13, 1932, that the prior submission of the case be set aside and that the case be reopened for further hearing.

9. The Board erred, in denying on May 31, 1933, petitioner's motion of August 10, 1932 in which petitioner moved that the Board vacate its order of April 13, 1932, setting aside the prior submission of the case and reopening it for further hearing.

10. The Board's findings of fact and decision are contrary to the weight of the evidence and contrary to law.

11. The Board erred in entering judgment against the petitioner and finding a deficiency in payment of tax for the year 1926 in the sum of $43,602.34, when in fact, there is no deficiency due.

IV.

Conclusion.

Wherefore, your petitioner prays that this Honorable Court may review said findings, decision, opinion, and orders
60 of the Board, and reverse and set aside the same to the extent of the assignments of error in the preceding paragraph, and that the Clerk of the Board be directed to transmit and deliver to the Clerk of this Court, certified copies of all and every of the documents necessary and material to the

presentation and consideration of the foregoing petition for review, and as required by the rules of this Court and statutes made and provided, to the end that the errors complained of may be reviewed and corrected.

J. S. SEIDMAN
Attorney for Petitioner
2 Lafayette Street
New York City

61 State of Illinois }
County of Winnebago } ss.

HUGO L. OLSON, being duly sworn, says that he is the Secretary and Treasurer of the John A. Nelson Company, the petitioner above named, and that as such, he has authority to and has signed the foregoing petition. That he has read the same and that the facts set forth therein are true to the best of his knowledge and belief and that said petition is filed in good faith.

HUGO L. OLSON

Sworn to and subscribed before me this 25th day of November, 1933.

ELSIE BROITZMAN
(Seal) *Notary Public.*

83 • • (Caption—44700) • • Filed Nov. 1933.

PRAECIPE FOR THE RECORD.

Filed Nov 28 1933

To the Clerk of the United States Board of Tax Appeals:

You will please prepare and, within sixty days of the date of filing of the Petition for Review, in the above stated case, transmit to the Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, certified copies of the following documents:

1. The docket entries of proceedings before the United States Board of Tax Appeals in the case above entitled.
2. Pleadings before the Board.
3. Division findings of fact and opinion (Division report) 24 B. T. A. 1031.

4. Order of the Chairman of the Board, dated December 19, 1931 pursuant to Section 601(b) of The Revenue Act of 1928, directing that the Division Report be reviewed by the Board.

5. Order of the Board dated April 13, 1932, setting aside the prior submission of the proceeding and reopening the case for further hearing.

6. Petitioner's motion filed August 10, 1932, to vacate Board's order of April 13, 1932.

7. Order of the Board dated August 19, 1932, setting petitioner's motion of August 10, 1932 for hearing on September 14, 1932.

8. Order of the Board and memorandum sur order, both dated May 31, 1933, denying petitioner's motion of August 10, 1932.

9. Findings of fact and opinion (28 B. T. A. No. 94) and decision (September 7, 1933) of the Board.

10. Petition for Review.

11. Statement of the evidence settled or agreed upon.

12. This Praecipe for the Record.

The foregoing to be prepared, certified, and transmitted as required by law and the rules of the United States Circuit Court of Appeals for the Seventh Circuit.

Dated, New York, November 28, 1933.

J. S. SEIDMAN
Attorney for John A. Nelson Company
2 Lafayette Street
New York, N. Y.

84 * * (Caption—44700) * *

ORDER ENLARGING TIME.

For cause appearing of record, it is

Ordered: That the time for transmission and delivery of the record sur petition for review of the above entitled proceeding in the United States Circuit Court of Appeals for the Seventh Circuit, be and it is hereby extended to January 31, 1934.

(Signed) EUGENE BLACK
Member.

Dated: Washington, D. C.,
Jan. 23, 1934.
jd

Now, January 24, 1934, the foregoing order certified from the record as a true copy.

B. D. GAMBLE
(Seal) *Clerk, Board of Tax Appeals.*

85 * * (Caption—44700) * *

CERTIFICATE.

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 90, inclsive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 24th day of Jan., 1934.

B. D. GAMBLE
(Seal) *Clerk, United States Board of Tax Appeals.*

[fol. 70] At a regular term of the United States Circuit Court of Appeals for the Seventh Circuit, begun and held in the United States Court room in the City of Chicago, in said Seventh Circuit on the third day of October, 1933, of the October Term in the year of our Lord One Thousand Nine Hundred and Thirty-Three and of our Independence the One Hundred and Fifty-Eighth.

5146

JOHN A. NELSON COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

Petition for Review of Order of the United States Board of Tax Appeals

And on, to-wit: On the second day of February, 1934, there was filed in the office of the Clerk of this court an appearance of counsel for petitioner, which said appearance is in the words and figures following, to-wit:

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1933

No. 5146

JOHN A. NELSON COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

The Clerk will enter my appearance as counsel for the petitioner.

Jacob S. Seidman, 2 Lafayette Street, New York, N. Y.

Endorsed: Filed February 2, 1934. Frederick G. Campbell, Clerk.

[fol. 71] And afterwards, to-wit: On the eighth day of February, 1934, there was filed in the office of the Clerk of this court an appearance of counsel for respondent,

which said appearance is in the words and figures following, to-wit:

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1933

No. 5146

JOHN A. NELSON COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

The Clerk will enter our appearance as counsel for the respondent.

Sewall Key, Washington, D. C.

Endorsed: Filed. Frederick G. Campbell, Clerk, February 8, 1934.

And afterwards, to-wit: On the third day of March, 1934, there was filed in the office of the Clerk of this court an appearance of counsel for respondent, which said appearance is in the words and figures following, to-wit:

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1933

No. 5146

JOHN A. NELSON COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

The Clerk will enter our appearapces as counsel for the respondent.

E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue. Brooks Fullerton, Special Attorney, Bureau of Internal Revenue.

Endorsed: Filed March 3, 1934. Frederick G. Campbell, Clerk.

[fol. 72] At a regular term of the United States Circuit Court of Appeals for the Seventh Circuit, begun and held in the United States Court room in the City of Chicago, in said Seventh Circuit on the second day of October, 1934, of the October Term in the year of our Lord One Thousand Nine Hundred and Thirty-Four and of our Independence the One Hundred and Fifty-Ninth.

And on the same day, to-wit: On the eighth day of February, 1934, there was filed in the office of the Clerk of this court a Stipulation, which said Stipulation is in the words and figures following, to-wit:

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCOBER TERM, —

No. 5146

JOHN A. NELSON COMPANY, Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

STIPULATION

It is hereby stipulated and agreed by and between counsel for petitioner and counsel for respondent, subject to the approval of the Court, that the above entitled case which is on the October 1, 1934 calendar for assignment for oral argument, be passed until after December 15, 1934.

Dated, September 26, 1934.

J. S. Seidman, Counsel for Petitioner. Frank J. Wideman, Counsel for Respondent.

Endorsed: Filed October 2, 1934. Frederick G. Campbell, Clerk.

[fol. 73] And on the same day, to-wit: On the second day of October, 1934, the following further proceedings were had and entered of record, to-wit:

Tuesday, October 2, 1934

Court opened by proclamation.

Before Hon. Samuel Alschuler, Circuit Judge, Hon. Evan A. Evans, Circuit Judge, Hon. William M. Sparks, Circuit Judge.

5146

JOHN A. NELSON COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

Petition for Review of Order of the United States Board of Tax Appeals

It is ordered that this cause be, and the same is hereby continued.

And afterwards, to-wit: On the eighth day of January, 1935, the following further proceedings were had and entered of record, to-wit:

Tuesday, January 8, 1935

Court met pursuant to adjournment and was opened by proclamation.

Before Hon. Evan A. Evans, Circuit Judge, Hon. William M. Sparks, Circuit Judge, Hon. Louis FitzHenry, Circuit Judge.

5146

JOHN A. NELSON COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

Petition for Review of Order of the United States Board of Tax Appeals

It is ordered by the court that this cause be, and the same is hereby set down for hearing on February 1, 1935.

[fol. 74] And afterwards, to-wit: On the first day of February, 1935, the following further proceedings were had and entered of record, to-wit:

Friday, February 1, 1935

Court met pursuant to adjournment and was opened by proclamation.

Before Hon. William M. Sparks, Circuit Judge, Hon. Louis FitzHenry, Circuit Judge, Hon. Walter C. Lindley, District Judge.

5146

JOHN A. NELSON COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

Petition for Review of Order of the United States Board of Tax Appeals

Now this day come the parties by their counsel and this cause now comes on to be heard on the printed record and briefs of counsel and on oral arguments by Mr. J. S. Seidman, counsel for petitioner, and by Mr. Robert W. Anderson, counsel for respondent, and the court having heard the same takes this matter under advisement.

And afterwards, to-wit: On the twenty-third day of February, 1935, there was filed in the office of the Clerk of this court the opinion of the court, which said opinion is in the words and figures following, to-wit:

[fol. 75] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT, OCTOBER TERM, 1934, JANUARY SESSION, 1935

No. 5146

JOHN A. NELSON COMPANY, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent

PETITION FOR REVIEW OF DECISION OF THE UNITED STATES BOARD OF TAX APPEALS—February 23, 1935

Before Sparks and FitzHenry, Circuit Judges, and Lindley, District Judge

LINDLEY, District Judge:

The taxpayer petitions for a review of a decision of the Board of Tax Appeals, assessing additional taxes based

upon a holding that the transaction hereinafter discussed was not a reorganization within the meaning of the Revenue Act. Two questions are involved: first, whether a stipulation between the parties that on December 31, 1926, petitioner "was a party to a reorganization" is decisive of the question as to whether or not the transaction herein involved amounted to a reorganization within the meaning of Section 203 (h) of the Revenue Act of 1926; and, second, if such stipulation is not determinative, whether the transaction was a reorganization within the meaning of the statute.

In the stipulation of the parties before the Board, one recital was that on December 31, 1926, petitioner "was a party to a reorganization." If this stipulation is to be treated as an agreement "concerning the legal effect of ad- [fol. 76] mitted facts," it is obviously inoperative, "since the court cannot be controlled by agreement of counsel on a subsidiary question of law." Swift & Co. v. Hocking Valley Ry. Co., 243 U. S. 281, 289.

The actual question presented to the Board necessary to a final decision upon the merits was whether there was a reorganization. The stipulation was clearly an attempt to stipulate the existing facts to be within a certain legal definition. Whether there was a reorganization in view of all the facts presented was a question of construction of statutory law, and the agreement between counsel as to such construction was not binding upon the court and must be disregarded. It was either an agreement that entirely removed the question from the proceeding or it was an attempt to limit the function of the Board to decide the issues of liability. Consequently it is ineffective. To hold otherwise that a stipulation that facts which do not under the law constitute reorganization do effect a reorganization would necessitate that the court entertain a question which is not in actual controversy between the parties but one based upon the stipulation of the parties as to a fictional situation, thus presenting a moot case, Swift & Company v. Hocking Valley Ry. Co., 243 U. S. 281. See Smith v. Commissioner, 59 F. (2d) 533, holding that a stipulation that a certain transaction amounted to a gift did not exclude the Board or the Court from determining that question; United States v. Pugh, 99 U. S. 265, holding that the ultimate effect of the facts which the evidence establishes is in the nature of a question of law subject to review by

the Court. The question of what constitutes a reorganization is one that arises from a consideration of all the facts and is not determined by a mere label or rubber stamp which the parties themselves put upon as the transaction. Gregory v. Helvering, — U. S. — (January 7, 1935). The Board, therefore, had before it for determination the question as to whether or not a reorganization occurred.

The facts are undisputed and disclose that the transaction does not come within the intendment of the congressional definition of reorganization. On November 18, 1926, petitioner entered into a contract with Elliott-Fisher Company, a Delaware corporation, under the terms of which the latter agreed to organize a new corporation with a capital stock of 12,500 shares of (non-voting) preferred stock, and 30,000 shares of (voting) common stock and to [fol. 77] purchase all the common stock for $2,000,000 in cash. Thereafter the new corporation purchased from petioner substantially all of its property, with the exception of $100,000 in cash, paying therefor to petitioner $2,000,000 in cash and 12,500 shares of preferred stock in the new company. Out of the cash thus received petitioner called for redemption and retired its own preferred stock and distributed to its stockholders the preferred stock of the new company and the remainder of the cash received as purchase price. Petitioner was not dissolved. It retained its franchise and $100,000 in cash and acquired no interest in the corporation to whom it delivered its property, other than the preferred shares of stock, which it distributed to its stockholders. This preferred stock had no voice in the control of the new corporation, except in case of default in payment of dividends thereon. Petitioner remained liable for certain liabilities and for taxes.

When we analyze these facts it is apparent that the transaction essentially constituted a sale of the greater part of petitioner's assets for cash and the preferred stock in the new corporation, leaving the Elliott-Fisher Company in entire control of the new corporation by virtue of its ownership of the common stock.

The controlling facts leading to this conclusion are that petitioner continued its corporate existence and its franchise and retained a portion of its assets; that it acquired no controlling interest in the corporation to which it delivered the greater portion of its assets; that there was no continuity of interest from the old corporation to the new;

that the control of the property conveyed passed to a stranger, in the management of which petitioner retained no voice.

It follows that the transaction was not part of a strict merger or consolidation or part of something that partakes of the nature of a merger or consolidation and has a real semblance to a merger or consolidation involving a continuance of essentially the same interests through a new modified corporate structure. Mere acquisition by one corporation of a majority of the stock or all the assets of another corporation does not of itself constitute a reorganization, where such acquisition takes the form of a purchase and sale and does not result in or bear some material resemblance to a merger or consolidation. As was said in West Texas Refining & Development Co. v. Commissioner, 68 F. (2d) 77:

"The purpose of section 203, supra, was to relieve corporations from profits taxes in cases where there is only a [fol. 78] change in corporate form without an actual realization of any gain from an exchange of properties. It is intended to apply to cases where a corporation in form transfers its property, but in substance it or its stockholders retain the same or practically the same interest after the transfer. See Cortland Specialty Co. v. Commission (C. C. A. 2) 60 F. (2d) 937, 940; Pinellas Ice & Cold Storage Co. v. Commissioner, 287 U. S. 462, 53 S. Ct. 257, 77 L. Ed. 428; Id. (C. C. A. 5) 57 F. (2d) 188. Here it was contemplated that in substance the West Texas Company should dispose of its assets and receive therefor a cash consideration, and also stock. What was done amounted to a single transaction for income tax purposes, and when it was fully consummated the West Texas Company had received only a 50% stock interest in the Col-Tex Company and $184,771.34 in cash. Therefore the transaction was not within the exceptions defined in section 203 supra, and must be considered as a sale."

In the recent case of Gregory v. Helvering, supra, the Supreme Court has pointed out that it is essential, in order to carry into effect the intent of Congress in this respect, that an examination of the facts be had to determine whether there was indeed reorganization, even though the parties themselves may call a transaction a reorganization.

The court held that though it had no right to inquire into the motive of taxpayers in performing a legal act, it did have a right to say that the claim of reorganization was a mere legal fiction.

The decision of the Board of Tax Appeals is affirmed.

[fol. 79] And on the same day, to-wit: On the twenty-third day of February, 1935, the following further proceedings were had and entered of record, to-wit:

Saturday, February 23, 1935

Court met pursuant to adjournment and was opened by proclamation.

Before Hon. Evan A. Evans, Circuit Judge; Hon. Louis FitzHenry, Circuit Judge; Hon. Walter C. Lindley, District Judge.

5146

JOHN A. NELSON COMPANY

vs.

COMMISSIONER OF INTERNAL REVENUE

Petition for Review of Order of the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof: It is now here ordered and adjudged by this court that the decision entered in this cause on September 7, 1933, by the United States Board of Tax Appeals be, and the same is hereby affirmed.

[fol. 80] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

I, Frederick G. Campbell, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit, do hereby certify that the foregoing typewritten and printed pages,

numbered from 1 to 10, inclusive, contain a true copy of the proceedings had and papers filed, excepting briefs of counsel, and stipulations and orders relating to the time for filing briefs in the case of John A. Nelson Company, Petitioner, vs. Commissioner of Internal Revenue, Respondent, No. 5146, October Term, 1934, as the same remains upon the files and records of the United States Circuit Court of Appeals for the Seventh Circuit.

In testimony whereof I hereunto subscribe my name and affix the seal of said United States Circuit Court of Appeals for the Seventh Circuit, at the City of Chicago, this 17th day of April A. D. 1935.

(Seal United States Circuit Court of Appeals, Seventh Circuit.)

Frederick G. Campbell, Clerk of the United States Circuit Court of Appeals for the Seventh Circuit.

[fol. 81] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 14, 1935

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Seventh Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.